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17 September 2015

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Welcome to the New World of Business.

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PICK N PAY AND THE POWER OF PLASTIC

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QUESTIONING THE RAND'S POSITION

GARETH BRICKMAN COMMENTS ON THE ARTICLE *WHAT DOES CURRENT MARKET VOLATILITY MEAN FOR THE RAND?*, PUBLISHED ON FINWEEK.COM ON 24 AUGUST:

The author's prognosis pretty much rests on the external deficit improving and the assumption that "the rand has now entered very dangerous and oversold territory".

While a narrower deficit should theoretically reduce the rand's fragility, it's not so clear cut as to say it will materially aid the currency. The deficit was a symptom of underlying economic imbalances that are yet to be expunged (e.g. excessive demand due to credit). Government finances look

wobbly and have to be tightened. The fallout from this will reflect on the capital account rather than the current account (goods and services) as capital investment is slowed and/or pulled from the country. SA could thus still have an overall balance of payments deficit problem, even as the goods and services deficit narrows/turns to a surplus.

Secondly, it is not at all clear that "the rand has now entered very dangerous and oversold territory". This statement could have been made many times in recent years when comparing the nominal exchange rate to what we've seen in the past.

But this view would have turned out disastrously wrong for anyone taking a position on it. The issue is that the foreign exchange regime in SA is open,

so flow dynamics have an outsized impact. If capital is withdrawing from the country even as the current account deficit improves, this process can still push and keep the currency in a materially undervalued state for quite some time. This also excludes the fact that on a real, trade-weighted basis it is not at all clear-cut that the rand is exceedingly undervalued. While the nominal depreciation has indeed been much starker and looks very scary compared to the past, depreciation in real terms has lagged and could still have gas in the tank. My final thought when assessing the analytical weight behind the prognoses of the medicine men of finance would be to echo the advice of Albert Einstein: "Everything should be made as simple as possible, but not simpler." ■

Double take

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BETTING ON PLATINUM

R4.5bn

The minimum amount Sibanye Gold will pay for Anglo American Platinum's Rustenburg operations, which employ 16 000 people and was hit by a record five-month strike last year. As part of the deal, Sibanye will pay R1.6bn upfront in cash or shares and a deferred contribution equal to 35% of distributable free cash flow generated by Rustenburg over a defined period. The minimum amount payable out of cash flow will be R3bn.

In Brief

CHINESE IMPORTS DROP

14.3%

China's imports fell 14.3% in August in yuan-denominated terms from a year ago, reflecting lower commodity prices globally, while exports fell by 6.1%, bbc.com reported. As a result, China's monthly trade surplus increased by nearly 40% to \$57.8bn (R786bn). The lower trade figures were seen as a further sign of China's industrial slowdown. The country has downgraded its growth rate for 2014 from 7.4% to 7.3%, the lowest in 25 years.

Ivan Glasenberg
CEO of Glencore

COMMODITY CASH CRUNCH

\$210M

The amount (R2.9bn) of his own cash that Glencore CEO Ivan Glasenberg will put forward as part of a \$10.2bn programme to raise capital, cut costs and conserve cash (also see page 16), according to guardian.com. Johannesburg-born Glasenberg, who owns 8.4% of the commodity trading and mining group, and four members of his senior management team would need to cough up \$550m in total to retain their 20% stake in the businesses following the \$2.5bn capital raising, guardian.com reported.

US JOBS INCREASE

5.1%

The US unemployment rate fell to 5.1% in August, slightly lower than the market expectations of 5.2%, though non-farm payroll numbers disappointed. The level of US employment is now almost 4m above the peak prior to the global financial market crisis, Stanlib's Kevin Lings says. August's modest gain in employment might not entice the Federal Reserve to start raising interest rates this September, but there is still a high probability that it will increase interest rates before the end of 2015, according to Lings.

PARLIAMENTARY NO-SHOW

2010

Minister of labour **Mildred Oliphant** has not once appeared before Parliament's portfolio committee on labour since her appointment in 2010. The DA said every attempt made by the opposition to get her to appear before the committee has been blocked by the ANC, spearheaded by Lumka Yengeni, the committee's chairperson.



Gallo Images /Sowetan /Veli Nhlapo

RECORD YEAR FOR M&A?

\$40BN

This could be a record year for mergers and acquisitions (M&A), with \$40bn (R545bn) in new transactions announced globally on 8 September alone, bringing the total since January to over \$3tr, *Financial Times* reported. Despite turmoil in Chinese markets spilling over to international exchanges, deal-making activity has not been dampened. Deals worth more than \$300bn were announced in the US last month, making it the busiest August in US history for M&A, it said.

THE GOOD

China's announcement on 8 September that it will increase infrastructure spending, accelerate major construction projects and reform taxes to stimulate its economy helped to strengthen commodity prices and stock exchanges around the world. While time will tell how sustainable the boost will be, it may give some breathing room to commodity exporters in particular as they struggle to adapt to slowing growth in the world's second-largest economy.

THE BAD

Figures released by the International Air Transport Association (Iata) show a 21% decline in year-on-year ticket revenue for tickets purchased to travel to SA, with the tourism industry blaming new visa regulations for the lower numbers. Minister of tourism Derek Hanekom urged role players to wait for Cabinet to finalise its review of the regulations, which include a requirement that children travel with unabridged birth certificates. Let's hope the review goes faster than the process of actually getting an unabridged birth certificate.

THE UGLY

Ratings agency Fitch warns that the risk of a further downgrade to SA's credit rating is increasing. Another downgrade from Fitch, which currently rates the country as BBB with a negative outlook, would give SA's debt junk status. This would not only lead to higher debt service costs on government debt, but would also have a knock-on effect on the cost of servicing (and raising) debt for parastatals such as Eskom.

ROYAL FORTUNES

\$425M

Queen Elizabeth II, who became the longest-reigning monarch in British history on 9 September, is worth about \$425m (R5.8bn), according to Bloomberg Billionaires Index. The value of the monarchy, which includes assets such as Buckingham Palace, the Crown Jewels and the Royal Art Collection, is estimated at \$87bn. These assets, however, are held in trust and don't belong to the Royal family. The Queen's personal assets are estimated to include \$75m of investments, \$110m of personal property, a \$75m stamp collection and the \$10m rated Royal Stud, according to the Bloomberg Billionaires Index.



Queen Elizabeth II

“

“I don't think the Fed lift-off itself is going to create a major crisis but it will cause some immediate turbulence. It is the compounding effect of the last two weeks of bad news

with that [China devaluation]... The world economy is looking too troubled – if the US goes in for a very quick move in the middle of this I feel it is going to affect countries quite badly.” – World Bank chief economist Kaushik Basu warns in an interview with the *Financial Times* (FT) that the US Federal Reserve risks triggering “panic and turmoil” in emerging markets if it decides to raise rates at its September meeting for the first time since 2006, a move that is widely expected. He urged the Fed to refrain from raising rates until the global economy is on a surer footing, FT reported.

International clothing retailers still on the rise in SA

BY BUHLE NDWENI

Despite a tough economic climate, international fashion brands are performing well in South Africa. Australian fashion retailer **Cotton On Group**, which entered SA's fashion retail scene in 2011, has been going from strength to strength and is looking at extensive expansion within the next 12 months. Meanwhile, Swedish fashion retailer Hennes & Mauritz (H&M) will be launching its first South African store in Cape Town next month.

Increased demand for globally recognised fashion brands has led to an influx of trendy international fashion retailers onto South African shores over the past couple of years. And despite the common belief that tough economic times would slow the growth of these international brands as consumers experience increased financial pressure, these fashion retailers are still on the rise in SA.

The power of social media and online retailing (e-commerce) has made the retail space more competitive, as consumers can see the latest international fashion trends in real time. The availability of these international brands in SA offers fashion-forward consumers a better shopping experience. Consumers can keep up with global trends, something SA-based fashion retailers fail to do as they order ahead of season.

Spanish fashion retailer Zara, which entered SA in 2012, will be opening store number seven at the end of the year. Merchandise is delivered in stores twice per week in response to items demanded by customers.

Sweden-based fashion retailer H&M will also be joining international fashion retailers in the SA market when it launches its first store at the V&A

Waterfront's The Victoria Wharf Centre in Cape Town next month.

Meanwhile, beginning September, Australian fashion retailer Cotton On Group – which entered SA's fashion retail scene in 2011 and currently has 130 stores in SA – announced plans to double the size of its local business by opening 100 new stores within the next 12 months; 40 new stores by Christmas and another 60 in the first half of 2016.

While the group has no immediate plans to further expand into other countries on the continent, it opened its first two stores in Namibia in May this year, under its Johannesburg-based regional hub Cotton On South Africa.

The fashion trends can, of course, go either way. With Australia and SA sharing the same climate, Cape Town-based retailer Woolworths also made a number of acquisitions in Australia, with David Jones being the latest last year. And earlier this year, local fashion-for-value retailer Mr Price, which has performed well across the African continent, also announced plans to open stores in the Australian cities of Melbourne and Sydney.

Cotton On Group CFO Michael Hardwick says as a fashion retailer with a presence in 17 countries, both in the southern and northern hemisphere, there are fashion trends that resonate with its brands across the globe. "These are really driven by access to social media and the internet as well. There's lots of



Michael Hardwick
Group CFO of Cotton On

consistency now in sellers in SA and Australia, Brazil and parts of Asia," says Hardwick, adding that they will introduce products into a market where they see localised opportunities. Six of Cotton On's seven brands are currently in SA. These are Cotton On, Cotton Kids, Cotton On Body, Typo, Rubi Shoes and Factorie in SA. The seventh brand Supré, a brand for fashion-forward women and girls aged 14 to 18, will be introduced in SA in 2016.

"For us there is a lifestyle similarity between Australia and the Southern hemisphere," says Hardwick. "It's outdoors, it's fun, it's young and energetic. And that's what's different from some of the northern hemisphere brands that are coming to the southern hemisphere as opposed to a company such as us that has a legacy within the southern hemisphere."

Globally, the group has expectations to continue growing in excess of 20% year-on-year; in SA it expects to grow in excess of 50%. "South Africa is becoming a more important part of our global business, even though today it represents 12% internationally. It's been a very important part of our growth strategy," says Hardwick. In terms of the Cotton On Group's brands, globally Cotton On represents 50% of the market and the remaining five brands represent 10% each. The same is true in SA. ■

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THE PAST COUPLE OF YEARS HAVE SEEN AN INFLUX OF TRENDY INTERNATIONAL FASHION RETAILERS ONTO SOUTH AFRICAN SHORES.

How does Buhari measure up?

What can you tell about a presidency in 100 days? According to Nigeria's media commentary last week, everything. Beyond the bluster, I have been thinking about the ways in which I have noticed a difference since Muhammadu Buhari was inaugurated at the end of May – a one-woman survey if you will.

ELECTRICITY

This is definitely better. I ran out of candles the other day and didn't instantly run to the shop in anticipation of an evening in the dark. Some days we have no power cuts at all, making me (and certainly many others) more productive. Recently, there have been days where I've wondered why it was so quiet around town, only to realise it's the lack of roaring generators. You can attribute this to Buhari or to rainy season, which helps hydropower generation. The drier weather later this year and early next will be the test.

CORRUPTION

I can only really check this at street level by how many policemen and soldiers are asking for bribes, how often I am still being pulled over for 'traffic infractions' and so on. The answer is that I am asked for cash just as often as I was under the Jonathan administration, but my refusal on the basis that the president wouldn't approve is now taken seriously rather than shot down as hypocritical. Still, it's the corruption at ministry level that needs fixing in order for a trickle-down effect to start and, without ministers appointed, there's no one but the president to lead by example.



Muhammadu Buhari
President of Nigeria

A MAMMOTH STRUCTURAL OVERHAUL OF NIGERIA'S FUEL PROCUREMENT IS NECESSARY TO PREVENT A RETURN TO DAY-LONG WAITS FOR PETROL.

Ministerial appointments are expected this month, but Nigeria-time means that could be any time.

FUEL QUEUES

Described in a national newspaper article by Buhari's spokesman last week as having 'vanished', the fuel queues took longer to evaporate after the inauguration than expected, and a mammoth structural overhaul of Nigeria's fuel procurement is necessary to prevent a return to day-long waits for petrol. That said, some of Nigeria's oil refineries are said to be back up and running, which should help cushion the country from further supply shocks for now, and the government has started a harsh crackdown on illegal refining activities in the Niger Delta, which could limit the hundreds of thousands of barrels of crude oil thought to be lost to theft every day.

SECURITY

Abuja (I am crossing my fingers as I write) has been safe from bombings since the election, but speaking for myself isn't useful. If I was in the northeast, it would be a different story; Boko Haram continues its bloody campaign and hundreds have been killed by the sect since Buhari's inauguration. Much of the momentum Jonathan gained against Boko Haram in the last weeks of his administration seems to have been lost. Buhari's recent pledge to end the insurgency within three months looks unwise at best: while Buhari has been working on regional cooperation with its West African neighbours and has rebuilt diplomatic ties with the US, there's a very long way to go and similar promises came back to bite Jonathan. ■

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PICK N PAY AND THE POWER OF PLASTIC

BY THE *FINWEEK* TEAM

As retailers fight for market share, Pick n Pay recently introduced a seemingly insignificant marketing tool – Stikeez. Shoppers receive these small plastic figurines as reward for every R150 worth of purchase. The real reward, however, is a believed surge in the retailer's sales figures.



No one saw it coming. The promotion was off to an unpromising start, with many shoppers expressing irritation and confusion about the unwanted tat in their shopping bags.

Then came Pick n Pay's heavy-handed attempts to censor a light-hearted blog by an exasperated mother who wished "drug-resistant chlamydia" on those responsible for introducing her

kids to Stikeez. But those only turned out to be temporary hitches in what is emerging as one of the most effective promotional campaigns in local retail history.

Soon the critics accusing Pick n Pay of cynically marketing to children were drowned out by other complaints: Why can't I buy Stikeez at the till? How come alcohol purchases don't qualify for Stikeez? Why doesn't my nearest store have the penguin one? Suddenly, they

were everywhere. Stikeez swept through schools, turning playgrounds into sophisticated trading floors as children swapped their figurines to amass complete sets with all 24 characters.

Often, transactions turned nasty and some schools started banning Stikeez, only fuelling their allure. Stores were suddenly full of children, egging their parents on to buy just a little bit more so their purchases would amount to another R150 at the till, to qualify for

another free figurine.

Adults also took an interest, and across the country wine glasses and computers were soon decorated with the suction-cupped stuff. Online buying and selling flourished, with fans setting up Facebook groups to swap figurines. Some Pick n Pay stores have experienced shortages and many have seemingly sold out of Stikeez display albums.

"It has been phenomenal," says Chris Gilmour, retail analyst at Absa Wealth and Investment Management. "A quite incredible and very clever campaign, which has taken everyone by surprise." He couldn't recall a previous retail promotion that captured the public's imagination in this way.

"You have no idea how big this is," a slightly harassed-looking manager of a large Pick n Pay store told *Finweek*, as he watched children in Stikeez-costumes pose with adoring fans.

"Where a shopper would normally spend R90 on a basket, we are seeing parents adding items to reach R150. And when they have more than one child, the R90 basket becomes a R300 shop." Given that the wholesale price of a Stikeez figure is in the region of 40c, this is an almighty cost-effective sales bump.

Pick n Pay isn't the first retailer to use Stikeez, but in some countries the German discount giant Lidl – which ran similar campaigns in a number of European markets – also allowed shoppers to buy the figurines separately at the till, potentially muting the leveraged impact on sales. (Pick n Pay has in recent days given in to pressure, and will start selling individual units for R4.95 each.)

KIDDIE POWER

Why have South Africans fallen so hard for the odd-looking characters? The country's demographics – almost 30% of the population is younger than 15 – mean that any youth-based marketing campaign will have much greater success than in more mature countries, says Gilmour. Stikeez benefits from 'pester power', a marketing term coined in

the late 1970s describing how children can influence their parents' shopping choices using one of the most powerful forces in the known universe: constant nagging. In the past decades, parents have become much more obsessed with the happiness of their children than those of previous generations – while at the same time having less time to spend with them, as now both parents are often working. This has given children increased emotional leverage and influence over their parents' spending decisions.

But what really set the Stikeez campaign apart was its unexpectedly broad appeal among other age segments as well, says Sane Mdalose, senior associate consultant at Aperio, a fast-moving consumer goods consultancy. It was exceptionally popular among young adults, right through to older people who used them as small gifts for grandchildren.

Contributing to the success of Stikeez compared to collectable campaigns in the past are the many more channels available to marketers, says Gilmour. Social media, the internet, apps (Stikeez now also has its own game) have all strengthened the onslaught.

Pick n Pay also made effective use of AdLites, internally illuminated street signs which were located at key intersections in close proximity to its shops, says Mdalose.

The success of Stikeez compared to other promotional campaigns is also

“

WHERE A SHOPPER WOULD
NORMALLY SPEND R90 ON
A BASKET, WE ARE SEEING
PARENTS ADDING ITEMS TO
REACH

R150.
”

MEET THE STIKEEZ

The SA campaign features 24 characters, ranging from monsters to farm animals. Each has its own name – such as Giry Joe the giraffe and Guinny the penguin, among others – and can stick to any flat surface (even car bumpers) due to patented suction cups, according to a Pick n Pay spokesperson, who claims the best part of Stikeez is “the resounding ‘pop’ they make when pulled off”. Created by Zing, an independent toy manufacturer based in Hong Kong, the campaign is managed by the Dutch marketing company Brand Loyalty.

According to the spokesperson, the campaign won't be extended beyond 20 September. However, if Pick n Pay followed Lidl's example, a new collectible set of Stikeez (with a marine life theme) may be introduced soon. Following pressure from German consumer groups, Lidl has reportedly agreed to make Stikeez available in transparent bags in that market to ease collector frustration.



due to the instant gratification and certainty of receiving a physical reward, says Mdalose. The shopper doesn't have to take chance on a scratch card, build up credits towards some prize or enter a draw.

Pick n Pay has been lagging with promotions, with Shoprite and Checkers for example running much more effective bulk promotion (two-for-the-price-of-one type) campaigns, says Mdalose. “But with Stikeez, its campaign execution was exceptional, with stocks mostly replenished in time and staff engaging with clients at the tills.”

In addition, Pick n Pay – probably inadvertently – picked a perfect time to introduce a new craze after the all-consuming loom band phenomenon petered out in recent months.

It may all seem like a bit of fun, but for Pick n Pay the stakes are deadly serious.

THE INVESTMENT CASE

The market usually loves a redemption story and Pick n Pay's turnaround is textbook stuff. The company is doing all the right things: cutting costs, improving efficiencies, delivering strong earnings growth.

Still, many investors won't touch it with a barge pole. The company is trading at a price-to-earnings ratio (P/E) of 36 times – by comparison, the UK retailing giant Tesco trades at 15, while a retailer like Sainsbury's is trading at a discount to the value of its properties alone, placing zero value on the supermarket business and brand, says Nic Norman-Smith of Lentus Asset Management, which manages discretionary portfolios for clients. "I won't look at Pick n Pay until it moves down to a more rational 15 to 20 times."

He says the company is clearly priced for rapid growth, at a time of slowing economic momentum and consumer pain. Norman-Smith believes the middle-income market, Pick n Pay's main consumer base, looks set to take enormous strain in coming months amid rising prices and job losses.

Pick n Pay is incredibly expensive in a very tough environment, says Chris Gilmour of Absa Wealth and Investment Management.



NOT ALL FUN AND GAMES

Due to chronic underinvestment in its own operations and a futile fixation on its struggling Australian supermarket group (in the end, Franklins was sold off), Pick n Pay was bleeding money and market share when ex-Tesco executive Richard Brasher took the reins in February 2013.

The company has since made solid progress in addressing some of its operational problems, with focused financial control, better capital management and aggressive cost-cutting ending a "lengthy period of spiralling costs", according to its latest results statement. For the year to end March, its headline earnings jumped 28% with trading expenses increasing only 3.8% on a like-for-like basis. And while still unimpressive compared to Shoprite's 5.6%, Pick n Pay has improved its trading margin markedly to 1.9%.

Still, a large piece of the turnaround puzzle remained missing. Brasher promised a "consumer-driven, sales-led" recovery, but this has not materialised. Sales grew only 6.1% to R66.9bn in the last year. This was blamed on the closure of some 40 unprofitable stores over two years, and financial pressure on customers.

In the same depressed environment, Shoprite (+11%) and Woolworths Foods (+13.5%) managed sizeable turnover growth. Clearly Pick n Pay was still losing market share to other retailers, albeit at a slower rate than before.

Can Stikeez help turn this around? One store manager told *Finweek* he

saw strong double-digit growth in sales since the introduction of Stikeez in early August, but a source close to the company says some reports that group sales grew as much as 12% to 15% due to the campaign were "laughably" unrealistic. (The retailer is in a closed period and did not want to comment on the financial impact.)

Alec Abraham, retail analyst at Sasfin Bank, does not think Stikeez will have a lasting, substantial effect on sales. He believes the company should continue to focus on strengthening its central distribution structure, which can help it to enter the only area of retail that offered strong growth in recent years: convenience stores.

Pick n Pay has fallen far behind other local retailers in being able to supply its stores with the products they need, as they need it. For many years, other retailers have invested in sophisticated central distribution structures that can deliver the right products in time. This means their stores can be smaller because onsite storage isn't necessary – shelves are replenished as needed.

Due to a dysfunctional central distribution system, Pick n Pay stores still remain reliant on direct deliveries from suppliers. Consequently most Pick n Pay stores have to store products in big onsite warehouses, which according to Abraham can take up to 50% of floor space. "They are paying retail rentals on warehouse space." If Pick n Pay can get its distribution right, the stores wouldn't need so much warehouse space – this will

PLASTIC NOT FANTASTIC

Pick n Pay is facing vociferous criticism from campaigners who believe the company is sacrificing its green credentials to score sales.

In an open letter, Rhian Berning, the founder of Eco Atlas, an online platform that allows consumers to search for "ethical" businesses, berated Pick n Pay for a "conniving" marketing campaign that has unleashed "tiny bits of plastic

made in China and individually wrapped in even more plastic, for free *nogal*, on the populace and landscape of SA".

Hayley McLellan, environmental campaigner at the Two Oceans Aquarium, has been "quite shocked" by the Stikeez promotion. "This powerfully marketed campaign is all about increasing footfall – and therefore spend – in their stores whilst ignoring the potential environmental cost.

Once the novelty wears off, discarded Stikeez and their associated packaging will put even more strain on South Africa's already precarious landfill sites and waste issues in general. We also fully expect to start finding the figurines in our beach cleaning-up operations in the future."

In response, Pick n Pay says that Stikeez will have a "negligible environmental impact" and are fully recyclable.



HOW THE RETAILERS STACK UP

SHOPRITE HOLDINGS

12 months to June 2015
Turnover up 11.2% to
R113.7bn



WOOLWORTHS HOLDINGS

12 months to June 2015
Turnover up 42.3% to
R58.5bn



PICK N PAY STORES

52 weeks to 1 March 2015
Turnover up 6.1% to
R66.9bn



SPAR GROUP

Year ended 30 September 2014
Turnover up 15% to
R54.5bn



MASSMART

Year ended December 2014
Turnover up 10.4% to
R78.2bn



save on rent, or stores can increase the size of their shop floor, adding to sales.

Hamstrung by its problematic distribution system, Pick n Pay has not been able to capitalise on the strong trend towards smaller convenience stores, where Woolworths and Spar have led the way. For many households, the large monthly or weekly shop at big stores are quickly being replaced by an almost daily stop at smaller outlets, says Abraham. This is partly due to time constraints as in many families both parents are now working, but

also part of the trend towards fresh produce and quality ready-made meals.

This growing food awareness has contributed to Pick n Pay's painful market share loss among upper-income clients, who now shop at Woolworths. Abraham believes it will be difficult to reverse this; Pick n Pay has fallen too far behind in delivering the same food innovation and quality offering, particularly in fresh foods. Gilmour agrees: "Woolworths is just streets ahead."

And trying to grow sales in the lower income segment (through its Boxer chain) also won't be easy, as Shoprite built a formidable store structure serving these clients while Pick n Pay was distracted by its ventures in Australia. Shoprite used much of its R8bn rights issue in 2012 to expand aggressively in peri-urban and rural areas, as well as in the rest of Africa, and pre-emptively secured the best sites for its new stores, making



Richard Brasher
Group executive of Pick n Pay

life difficult for entrants like Pick n Pay and Massmart. Shoprite's established distribution networks (and sunk costs) in these areas have added to its competitive cost advantage.

There are some factors in Pick n Pay's favour. Analysts expect the full benefits of its Smart Shopper Card initiative will only be felt in coming years, as the company starts benefitting from matching procurement with the data mined from consumers' shopping histories. Also, the company is making some inroads in Africa, and further improvements in its central distribution structure and trading margins should translate into earnings gains.

It is expected that Stikeez may also result in a welcome sales bump. Still – addressing Pick n Pay's main structural and legacy challenges, while weathering an economic downturn, will prove a stickier problem. ■

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"But even if every single customer threw away every single Stikeez into a waste bin, rather than recycling them, the environmental impact would be very small, and would represent just a tiny fraction of total plastic waste in South Africa. In fact, we'd have to run the campaign for 150 years – with every single person who has ever got one not keeping or recycling them – just to make up 1% of the plastic sent to landfill in any given year," it states.





David Constable
CEO of Sasol

Will Canada, Qatar roll out the red carpet for Sasol?

BY JANA MARAIS

Sasol is ready to drill for oil and gas off the Durban coast, but policy uncertainty is hampering further developments, says CEO David Constable. “We have 82 000km²; the seismics are well underway; we know there are reserves down there. We’re ready to go.”

For an energy-starved country like South Africa, where oil and gas is a nascent industry, this should be great news. But Sasol and its project partner, Italy’s Eni, won’t spend any more money on it for the foreseeable future.

“You can’t invest. You can’t even bring a drill rig down here because you don’t know what your investment ultimately looks like,” says Constable.

The main concern for oil and gas players is government’s long-stalled amendments to the Mineral and Petroleum Resources Development Act (MPRDA), which would give government the right to acquire any stake in the oil and gas sector at an “agreed price”.

Constable, like many critics of the amendments, believes that oil and gas should have their own legislation.

“The risk profiles are totally different between mining and oil and gas. [Exploring for hydrocarbons] costs a lot more. You have a lot of dry wells; it is high risk,” he explains.

SA has few proven resources, and therefore, says Constable, government

should first incentivise, and then “turn it up at some future date” by, for example, increasing royalties. “But having uncertainty and lack of direction doesn’t work for the oil and gas industry, and especially not now with the oil price.”

The MPRDA isn’t the only regulatory hurdle: Sasol’s other challenges include proposed carbon taxes, delays on government rules regarding fuels standards, changing BEE codes, air quality legislation, and massive Competition Commission fines that eventually get overturned on appeals, such as the recent R534m fine related to polymer pricing. Sasol has invested significantly to ensure that it is compliant with the raft of regulations

that govern its business, which is negated by further amendments to the various pieces of legislation.

Constable is particularly concerned about the BEE codes. “The dti [department of trade and industry] is trying to get their heads around ownership control. That’s a huge goalpost move. We’ve spent a lot of time and effort getting to level 4, and we’ll be right back at the bottom of the barrel when these new codes come into effect.”

Diversity in Sasol is at 65.2%, he says, and 50% in top management levels. On employment equity, Sasol is on track to reach its 2017 targets as agreed with the department of labour. “Preferential procurement, enterprise development... all the things we do on the existing scorecard is out the window.”

It is one of many moving goalposts, he says, which is likely to deter new investment.

“That to me is not certainty.”

FOREIGN OPPORTUNITIES

With low oil and gas prices forcing higher-cost producers out of business, countries whose economies are heavily reliant on the sector may start looking at “rolling out the red carpet a bit more” to investors, Constable reckons.

For Sasol, Qatar, where it already operates Oryx, a gas-to-liquids (GTL) plant, and Canada, where it has been suffering losses from its shale gas operations, could offer potential.

“A lot of contracts are coming up for renewal in the Middle East,” he says. “Qatar, for example, is concerned about the price they can get for LNG [liquefied natural gas]. That begs the question – well, let’s take that gas and build another GTL plant, which is an opportunity for us as well,” says Constable. An Oryx 2 can potentially leapfrog Sasol’s plans to build a GTL plant in Louisiana, he says.

While the \$8.9bn ethane cracker at the same Lake Charles complex in Louisiana is going full-steam ahead, Sasol moved the GTL plans, which would cost between \$11bn and \$14bn, “to the backseat” earlier this year

WHERE IS THE OIL PRICE GOING?

Hedge fund manager Pierre Andurand of Andurand Capital, who predicted the 2008 oil spike and subsequent crash, told the *Financial Times* in early September that he believes oil can fall to as low as \$25 to \$35 a barrel this year, with the global market to remain oversupplied in 2016 and 2017.

Sasol is more bullish, forecasting an oil price of \$50 to \$60 for the financial year to end June 2016, price levels Constable describes as “sustainable”. Vitol Group, the world’s largest independent oil trader, is predicting prices at between \$40 to \$60 a barrel into 2016, Bloomberg reported.

“\$25 to \$35 is not a sustainable number. Heck, if it goes down to \$25 or \$35, I’m going to buy more Sasol shares. [...] Because longer term, [towards the] end of this decade, we’re all going to be making a lot of money in energy. You think of the hundreds of billions of dollars that have been pulled back in capital investment from the majors and ourselves – everybody for that matter – there’s nothing going on right now other than projects that are already in place.”

Constable says prices will start “turning up” by late 2017 as output from non-Opec countries decline by 10m barrels a day by the end of 2018. Adding conservative demand growth projections, 15m barrels a day will be required in this time frame. Prices will continue to “turn up through the end of the decade, which is perfect for us because the cracker [under construction in Louisiana] comes online and we’ll see higher margins for our ethane-based chemical products, versus naphtha-based feedstocks in Europe”.

The wildcard is what Opec will do about production, says Constable. “If you look at most of those countries – where they are on their cost of production and their national budgets – they’re all in a world of pain. And they’re getting a little more noisy; they can’t take it much longer. So the wildcard would be – maybe not in the next meeting [December] but the meeting after [around mid-2016] – some type of production quota and a couple million barrels [cut] just to show some faith in the oil price firming up.”

following the drop in oil prices.

“It’s not in the trunk,” Constable says, adding that Sasol has reworked the original size and scope of the project as part of its strategy to adapt to lower oil prices, proving “robust” returns at an oil price of \$80 a barrel.

“I’m not going to say never to Canada either – they’re in a world of pain right now. They can’t sell gas in the US because the US has shale gas. Their oil is down to \$23 a barrel on oil sands,” he says. “It’s really a painful time for Western Canada. I think because of that they’re going to start thinking about being a little more friendly, like Louisiana was, to new industry. Industrial tax holidays, payroll rebates, you know – just nice incentives to get us more interested like Louisiana did.”

With gas being a “buyer’s market”, SA is in a strong position to negotiate contracts for LNG imports and build

a new industry around that, Constable believes.

Sasol has submitted a proposal as part of request for information (RFI) to the department of energy in July. This forms part of government’s plans to increase the contribution of gas to SA’s energy mix, including through LNG imports, a regasification terminal, setting up gas-fired power plants and bringing additional gas into the country’s piped grid. Special economic zones such as Richards Bay and Coega could work as entry portals for LNG, which would be a “great way to go” for power generation.

“Certainly we as an industry would need some protection on LNG prices from an exchange rate perspective, but other than that I think we could get there. You know, roll out the red carpet a little bit for a new industry.” ■

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Glencore's massive plan to bust debt

BY DAVID MCKAY

If any more proof were needed of how the world's largest investors have been spooked by the commodity market meltdown, look no further than Glencore's enormous \$10.2bn (R142bn) debt reduction plans unveiled on 7 September.

Ivan Glasenberg, CEO of Glencore, said in an interview with *Finweek* that his company's shareholders were worried metal prices could deteriorate further – a view he doesn't personally hold – but one that is reflective of broad market perception. As a result, Glencore is to cut debt to just above \$20bn.

"We don't think it [the market] will go lower. If it does, and we're wrong, it can't go that way for long because a lot of producers will then go cash negative and there will be closures. That is a doomsday scenario that I don't believe will come," he said.

Nonetheless, Glencore's shareholders – some of whom are the largest investors in the world such as Legal & General, Capital Research, and Norway's sovereign pension fund – insisted the company better hit its \$27bn net debt target.

The outcome is a multipronged initiative that sees cash outflows staunched by suspending the next two dividend payments (the final 2015 payout and the 2016 interim), capital expenditure cuts, asset sales, and a \$2.5bn equity issue.

Steve Kalmin, Glencore CFO, said the equity issue could take a number of forms – "we have a dozen options" – ranging from a vanilla rights issue, to a book-build, or a convertible bond.

Whatever the route taken, the steps will be painful for investors as Glencore will both excise yield by cutting the dividend while diluting existing shareholders' issuing equity.



"They [the debt reduction measures] are clearly designed so that the company can operate in current or materially worse market conditions," said Barclays Capital, adding that Glencore would also hope to get "short-sellers off their back". Shares in Glencore were 5% higher on the day of the announcement but at the time of writing are still 10% lower over the last seven days.

Glasenberg's view that shareholders' harum-scarum attitude to the market is unfounded is based on the notion that metal prices will respond to the basic shortage of metal as producers cut back.

"Just look at the copper cuts and the fall in grades. All this tonnage is being taken off the market, which will

eventually have a positive effect on price," he said, adding that although the world was predominantly negative about China, copper consumption had nonetheless increased by 2% to 3% this year while the group's order book in China was "looking stronger in H2 [second half of the financial year]".

Market fundamentals, however, seem to play second fiddle to the kind of investor sentiment that sent Glencore back to its debt reduction plans, especially in the platinum group metal market.

"I'm not sure if anyone does fundamental analysis anymore," said Terence Goodlace, CEO of Impala Platinum (Implats), at the firm's recent year-end results announcement. He was being somewhat facetious, but the exasperation is plain.

"There is a huge disconnect in what we are seeing with the prices and what is happening in the market. Of all our customers, not one has rejected any metal," Goodlace said. "We do know that demand is going to be muted, but we still believe that there will be supply deficits in time."

In the meantime, while the market remains in a funk over the extent of metal price weakness, short-sellers of mining shares are having a field day – one of the reasons why Glencore made its announcement, according to Investec Securities.

"There is a distinct smell of smoke in the air as Autumn is upon us in London and darker days mean a more distorted view in the shaving mirror," said the bank. "We think that the Glencore move could be construed as a masterpiece of spin. [...] This plan appears designed to paralyse the short-sellers, and so far it appears to have worked." ■

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New tech helps DRDGold widen its fine margins

BY DAVID MCKAY

In 2013 DRDGold commenced work to improve operating efficiencies. Errors in the tech implementation made for a bad start, but once this was remedied the company experienced an operational turnaround.

Extracting gold from Johannesburg's dumps is an exact science, which makes DRDGold – one of the principal operators in this sliver of the SA mining market – more of a technology company than a miner.

Take, for instance, the fact that retrieving an improved 0.26g to 0.29g/ton of rock re-mined means the company can lock in reserves – which didn't exist previously when the yield was 0.18g/ton – of 10 to 15 years. These are tiny margins and DRDGold CEO, Niël Pretorius, has to make sure the company's main processing plant in Brakpan runs without a hitch.

In order to improve efficiencies, the company embarked on a R650m technology programme in 2013.

The project didn't work initially and the company had to suspend the new technology while it found the fault. "In retrospect, we should have been more modular about installing the flotation fine-grind system. Instead, we commissioned everything in one flick of the switch, so when things went wrong, we couldn't figure out where the problem was," Pretorius says.

He acknowledges some complacency crept into the company's practices after several years of successfully converting DRDGold to a surface re-miner from its traditional activity of deep, marginal, underground gold mining.

Now, however, the new fine-grind technology – essentially a circuit that allows DRDGold improved recoveries – is humming along pretty well, helping

NEW FINE-GRIND TECHNOLOGY HELPED THE COMPANY TO A HEADLINE PROFIT OF

R38.7M

IN 2015 FROM R700 000 IN THE PREVIOUS FINANCIAL YEAR.

the company to a R38.7m headline profit for its 2015 financial year from R700 000 in the previous year.

The improved returns mean that the company could step back from a bid for new resources on the far West Rand of Johannesburg and focus on now mineable reserves "just beyond [its] garden gate". Existing reserves are also extended owing to the improved recoveries.

For all these fine margins, however, DRDGold remains very much a gold stock; at least, that's the way the market views the company as evidenced by the 28% decline in its share price from mid-July to mid-August, which was in line with liquidations in other SA gold stocks in the same time period.

"The market doesn't think about the company in specifics in so much as the technical analysis of the sector," says Pretorius. "It's caught up in the trend [around the gold market]."

The operational turnaround of the past two years, however, has swayed Pretorius to put off resigning from the business and he has signed a new three-year contract with DRDGold. ■

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THINGS ARE LOOKING UP

Shares in AngloGold Ashanti have raced up 30% in the last month, taking the year-to-date performance into the green, up some 5.5%; a rarity among SA gold shares.

In fact, none of the other main gold miners listed on the JSE can boast a positive performance this year, with Harmony Gold down a worrying 51% – a performance that saw 14% shareholder, African Rainbow Minerals, book a R534m impairment.

The reason for the outperformance of AngloGold is the handy sale of its US-based gold mine Cripple Creek & Victor (CC&V) for \$820m (R11.4bn) – a transaction that helped it buy back \$810m (R11.2bn) in bonds. The debt is only due in 2020, but at some 8.5%, it is extremely expensive money, raised at a time when the gold price plummeted.

Thus the market rewarded significant de-leveraging of the balance sheet, which helps remove the need to tap shareholders for funds (provided operations are cash flow positive); in the case of AngloGold, they are.

The sale of CC&V was so handsome that selling other non-core assets, such as AngloGold's Mali and Ghana mines, is no longer necessary. Should the gold market deteriorate further, however, the company has the firepower to further reduce debt.

There's also considerable upside should markets improve. "Should gold prices rise, we believe AngloGold offers compelling leverage to a medium term de-gearing story," said Kane Slutzkin, a research analyst at UBS.

FUND FOCUS

YOUR QUARTERLY REVIEW OF SA FUNDS

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September 2015

finweek

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An angry bear market can create considerable investment opportunities



Leon
Kok

The latest stock market volatility once again drove home the importance of being invested in top-rate funds. Not only have they done well over the long term, but they have proved extremely resilient over the past three months.

Most leading asset managers would probably agree that global investors are simply repricing stocks to reflect a more honest picture of earnings, options and the future. It's not the end of the world.

In addition, top managers offer a wealth of investment options, including the provision of professional management at an affordable price. Indeed, they make small investors beneficiaries of global expertise rather than being dependent on the proverbial 'around the corner know-alls'.

In this edition we highlight some of these. Two included in the Old Mutual offering are Peter Linley's R14bn Investors Fund, one of the biggest and oldest in the industry; and Peter Brooke's Edge 28 Life Fund, which has turned in a phenomenal annualised return of 17.8% in its first three years.

Coronation founder member and

former CIO, Louis Stassen, gives us an insight into his recently launched Global Equity Select Fund, the result of several years of preparation. It has a strong developed market bias but is flexible enough to include some exposure to the exceptional growth potential offered by emerging markets.

We also interviewed impressive industry players, Allan Gray's new chairman, Ian Liddle, and deputy CIO, Andrew Lapping. They provided some unusual insights into their operation. Perhaps predictably, they insisted that they'll continue to do things right, and set extremely demanding standards for themselves.

In the ongoing active management-passive management debate, Prudential CEO Bernard Fick presents excellent arguments for select active management in SA. His house, in the active management camp, has consistently outperformed market indices over long periods of time, net of fees. This, of course, has been made possible by, among other factors, exploiting short-term mispricing of assets.

We have consistently given coverage over the years to alternative assets, and

were delighted to receive an article from Stanlib Thought Leadership head, Gillian Jones. Greg Babaya, the house's infrastructure franchise head, co-authored it. Stanlib's infrastructure funds are ideal for large institutional funds, seeking predictable risk-return profiles.

The Stanlib Infrastructure Yield Fund, for instance, has a low correlation to the business cycle, offers diversification to an investment portfolio and is a good inflation-hedge, as the income streams are usually inflation linked.

As a parting remark, I urge you not to get swept away by the present market hype. If you make a long-term commitment to invest, you should stick with it for the long-term, and not allow emotional nightly TV viewing and/or gossip to push you out of the market. Patience is rewarded.

Although unit trusts can provide attractive returns over long periods of time, they don't necessarily provide them each and every year. And you can't predict in which years they will or will not perform.

Enjoy the read.

LEON KOK

Facing up to fixed income volatility

BY LEON KOK

Trying to make sense of what's currently going on in the wider fixed income environment is not easy, but Investec Asset Management portfolio managers Malcolm Charles and Peter Kent, and economist and strategist Nazmeera Moola made an excellent job of it at a recent briefing in Johannesburg.

Kent reiterated the widely held view that the domestic economy is in a tough spot, but said that 3% growth in South Africa wouldn't be impossible against the external environment, were it not for the many unnecessary handbrakes.

He was referring to a host of issues such as high levels of policy uncertainty, twin deficits, electricity constraints, labour-related production disruptions, structural problems in key sectors and the erosion of competitiveness.

Charles concurred: "We could make ourselves a lot more insulated to external shocks if we could eliminate these handbrakes. That's what's frustrating. With good sense we could make it a lot easier for ourselves."

Moola pointed out that the Reserve Bank's economic growth forecasts for 2015 had declined from 3.8% in May 2013 to 1.8% in July 2015, and are currently expected to be slightly above 2% for 2016 and 2.8% in 2017.

"Significant has been the impact of this downward structural shift in growth potential on domestic demand (such as weak consumer spending and lower vehicle sales), and it's not surprising that inflation is actually on the downside," she said.

Charles added: "The Reserve Bank is in a comfortable position

and is unlikely to increase interest rates significantly in the foreseeable future. Given that there is not much pressure on the demand side, it can afford to sit on its hands for some time. In fact, the hike that we had in July could easily have been postponed. You can say that the Reserve Bank is confidently ahead of the yield curve."

He observed that among the eight or nine domestic inflation drivers, almost all with the exception of food are down. In Eskom's case, in which price is regulated, there isn't much that the public can do, because they don't have the pricing power. And in the case of oil, which is in a downward trajectory, there's not much that they can do either.

"Back in Tito Mboweni's time a 10% currency depreciation led to a 2% increase in inflation. It then fell to 1% and it's now 0.8%. That, for instance, allows retailers to put enormous pressure on suppliers, who, in turn, are forced to cut costs to maintain margins.

KENT POINTED TO VARIOUS FACTORS KEEPING GLOBAL INFLATION AT BAY.

THESE INCLUDE:

- Subdued retail sales in the US and Europe; wage increases haven't been great; and gas prices are down by a considerable margin.
- China's stalling economy; production overcapacity; fixing of the currency; and consequent declines in global commodity prices.
- Emerging markets such as Brazil, Turkey and Russia having had their backs to the wall.

Signs of global deflation are also creeping through," he explained.

"Our view is that the US economy has made considerable progress – though not perfect – and the Fed could hike interest rates next month. US inflation is not going to be as bad as has been feared; and if you add the Chinese component, it adds to the story," he said.

Believe it or not, several leading emerging markets are faring worse than SA, from a policy perspective, added Charles. "Turkey has been very experimental and has lost quite a bit of credibility. Similarly with Brazil. Investment bank JP Morgan says that its central bank will be forced to hike rates to such an extent that it will put its economy into recession this year and that it will have to cut rates next year merely to regain credibility.

"The South African Reserve Bank, in contrast, has done everything spot on. It is one of the most credible in the emerging markets stable and is even better than some of its developed market counterparts," said Charles. ■



Investec Income Team portfolio managers (left to right): Peter Kent, Nazmeera Moola and Malcolm Charles

Splendid performance by the **Edge 28** fund

BY LEON KOK

The Old Mutual Edge 28 Life Fund has turned in a phenomenal annualised return of 17.8% (to June) in its first three years and attracted more than R3bn in assets under management.

This is well in excess of its CPI + 6% performance target and the performances of other balanced funds, which struggled to generate little more than a nominal 5%.

A unique Regulation 28 fund, Edge 28 is managed by Old Mutual Investment Group's MacroSolutions boutique head, Peter Brooke, and equities specialist Arthur Karas.

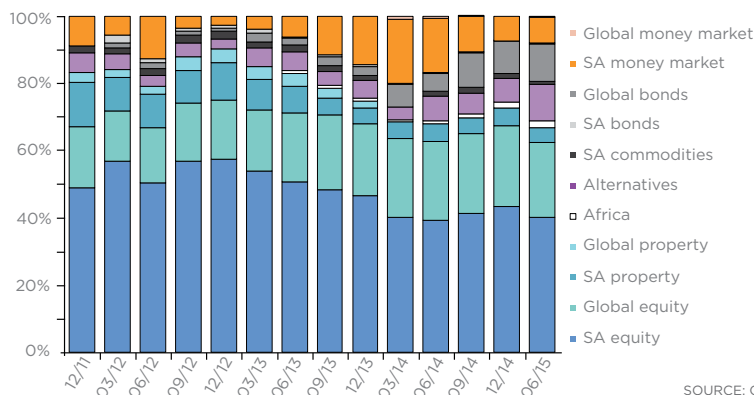
"No-one has anything like it and we've used the full flexibility of the Regulatory changes to drive it," says Brooke. "The fund invests primarily in growth assets with the maximum asset allocation under Regulation 28. It's mostly invested in equities, listed property and alternatives – such as private equity and hedge funds – with a small exposure to fixed interest and cash."

One reason that MacroSolutions can do this, he explains, is because the product is not set up as a unit trust, but as a life wrapped fund on the Old Mutual platform with access to all its building blocks in a compliant manner.

Currently more than 10% of the fund is invested in private equity and hedge funds, which are geared to generate superior long-term returns. On the equities side it's able to leverage most of Old Mutual's offerings, including its international assets.

"The fund is ideal for someone wishing to invest over at least a 10-year period," says Brooke. "We wouldn't recommend it over three years. If you're modestly conservative and nearing retirement, you'd probably be best advised to skip down a level on the risk side. On the other hand [...] people are increasingly likely to live

OLD MUTUAL EDGE 28 FUND: ASSET ALLOCATION OVER TIME



SOURCE: Old Mutual

for 30 years beyond retirement."

Brooke attributes the recent strong capital flows into Edge 28 to its market need; people seeking higher than average returns; and Old Mutual's track record in the active management space.

"Much of our outperformance so far has been the result of good asset allocation, good equity performances, and investing cash more effectively. It's also been driven by a number of different counters that you don't typically see in standard portfolios. These include Capitec Bank, Rhodes Food Group and Telkom."

Another contributing factor has been the outstanding performance of domestic listed property, which has been trimmed down to about 4.5% of the portfolio.

Edge 28's outperformance speaks to MacroSolutions being considerably more nimble than its larger competitors, Brooke notes. "However, we expect returns to slow down in the period ahead, a function of the more expensive market. But the nature of this fund should maintain it as a front runner among balanced funds."

In terms of asset positioning, he and Karas have cut the fund's domestic equity component to about 40% of the total portfolio, but remain fully invested in offshore shares, their preferred asset class.

It makes up about 22% of the portfolio.

"That has meant that a bit more cash has built up in the portfolio, [in addition to] listed property and bonds that we hold. [This] allows for new buying opportunities when they arise."

The fund's fixed income exposure is mainly concentrated on South African long end bonds which offer high yields.

In its international equity exposure, it has been overweight Japan and Europe, both of which performed well in the last period; it's been underweight emerging markets, helping it relative to several competitors who've held big overweight positions.

Brooke has lightened the fund's holding in listed property, which he believes will generate less real return going forward. "Valuations have become a bit stretched, but we have a significant position in UK listed property company Intu. Moreover, we've picked up one or two smaller offshore players that should deliver well in the long term."

Edge 28 is invested in little over 7% in private equity via broad-based exposure to a number of different players and a number of different geographies, including both international and Africa. Old Mutual is one of SA's biggest operators in this area. ■

A fund that **wins big** by not losing in the long term

BY LEON KOK

The Old Mutual Investors' Fund is undoubtedly one of the soundest long-term choices you could make in the domestic equity fund sector.

It's the oldest unit trust in the country – the favourite of thousands of consistently satisfied long-term investors – and boasts an impressive R14bn under management.

In spite of its size, it has generated a 19.6% annualised return over five years; 21.4% over three years; and 10.2% on one year. The annualised return since inception in October 1966 is 17.8%.

The fund is currently managed by Peter Linley and Jonathan Larcombe. Linley has worked in the industry for more than 30 years in various senior capacities, including as chief investment officer at Old Mutual Investment Group. He has been involved with the Investors' Fund for the past six years as head of Old Mutual Equities, a boutique within Old Mutual Investment Group.

Larcombe, a qualified chartered accountant with 14 years' experience in financial markets, has been extensively involved with private equity and managed the Global Technology Fund. Prior to joining Old Mutual, he spent several years in London with Grant Thornton and Credit Suisse.

Linley attributes the Investors' Fund's long-term success to the many talented investment professionals who have managed the fund over the years within a disciplined valuation-based philosophy. "The long-term success has not been the result of one person, and I guess that has added extensively to its sustainability," he says. The fund is fully invested in South African stocks.

The fund's mandate, he points out, is to focus predominantly on the Top 100 shares on the JSE, although he is constantly on the lookout for opportunities

among the smaller caps. Derivatives may be used for risk management purposes.

"Simply put, we buy stocks that are undervalued and sell stocks that are overvalued. A disciplined framework and long-term valuation horizon is essential given the subjectivity of valuations. In addition, we favour high-quality companies with superior earnings growth while we also carefully analyse the sentiment toward individual shares," Linley states.

He explains though that his team's approach is not overly value-based. "The trouble with a pure value approach is that it depends heavily on the subjectivity incorporated in any valuation and is often oblivious to market information. While we spend a huge amount of time determining valuation, we also look to extraneous factors that help long-term outperformance. The information is freely available and extremely useful and, used intelligently, adds value and helps avoid value traps.

"If sentiment on a particular stock is really negative, that might be of interest to us, firstly, because it may simply be neglected by the market, and secondly, further research may show that it offers

considerable opportunity.

"By the same token, if a stock shows great value, accompanied with considerable positive sentiment, it may give us more conviction for inclusion in the portfolio," he explains.

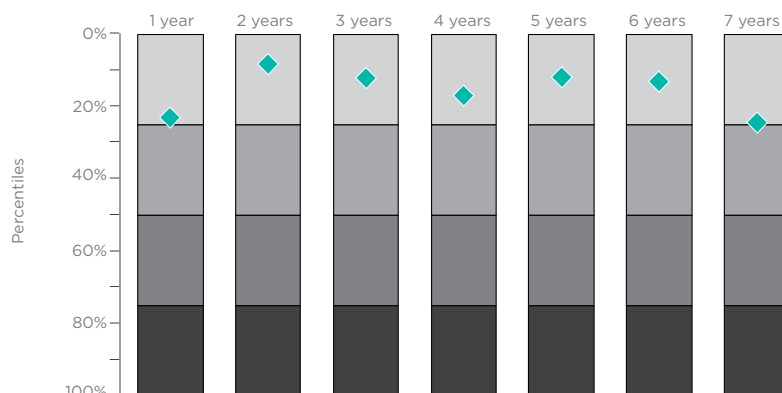
The portfolio currently retains a cyclical sector bias, specifically towards non-mining companies linked to the global cycle. "Opportunities among the South African focused businesses are limited in our view, given unappealing valuations," says Linley.

"We've had a very consistent hedge against the weaker rand for some years and that hasn't really changed. We have a big exposure to stocks such as Naspers*, SABMiller, British American Tobacco, Steinhoff, Datatec, Nectare, Old Mutual and Mediclinic," he says.

In short, the Investors' Fund is great for those investors seeking good long-term gains, attractive dividends and who are wary about losing big money. While it is an equity fund, and subject to market volatility, it's certainly not one geared to aggressive short-term capital appreciation and prone to harsh short-term setbacks. ■

*Finweek is a publication of Media24, which is a subsidiary of Naspers.

OLD MUTUAL INVESTORS' FUND IS TOP QUARTILE OVER 1, 2, 3, 4, 5, 6 & 7 YEARS



SOURCE: Morningstar, Old Mutual Investment Group

Coronation's global equity select offering

BY LOUIS STASSEN

FOUNDER MEMBER AND FORMER CIO OF CORONATION

Our recently launched Global Equity Select Fund is the result of many years of preparation. At Coronation, we are conservative in launching new funds and pride ourselves in not springing surprises on our clients. This launch is therefore the culmination of well-signalled plans to supplement our international offering with a direct developed market equity fund.

The launch of the fund provides investors with a new avenue to access global opportunities. In developing the mandate, we listened to the needs of our clients and have created a strategy biased towards developed markets, but still flexible enough to include some exposure to the exceptional growth potential offered by emerging markets.

We target attractively valued shares to maximise long-term growth for investors, aiming to outperform the global market indices through active stock-picking.

We have been building the dedicated developed market investment team for the past four years. Our team of five analysts is experienced and entrepreneurial, and works very closely with Coronation's large emerging markets investment team.

We know that we are taking on a daunting challenge, with the majority of global equity managers struggling to beat passive funds. However, we believe that the tried and tested approach that we have used in South Africa and elsewhere for the past 22 years is portable to developed markets.

A key tenet of our philosophy is our long-term horizon. We evaluate companies over periods of at least four to five years, which allows us the opportunity to ignore short-term noise



Louis Stassen
Founder member
of Coronation

and invest in assets that are trading at a discount to our assessment of their real long-term value.

As with all Coronation funds, we use our own financial modelling and valuations to determine the real long-term value of a company. We believe interaction with management teams is crucial, and it is an integral part of our analysis of a company. Consequently, we conduct multiple research trips each year to meet with managers and assess their businesses.

The information gathered directly from management teams feeds into our proprietary research, which drives all our investment decisions. In general, we favour US-domiciled companies, as in our experience, American management teams are entrepreneurial and often more shareholder-friendly than their counterparts elsewhere in the world.

The only difference between our

(dedicated developed markets team) approach and that of the South African investment team is the size of our universe. Given the magnitude of potential investments available to us, we have the luxury of focusing primarily on good-quality or above-average businesses that offer risk-adjusted upside.

Our research currently covers around 100 superior developed market companies, and an additional 165 emerging market companies. We like to say we try to avoid errors of commission, and not of omission – meaning that we would rather focus on understanding the companies we hold in our portfolio and getting that right, instead of chasing every opportunity out there.

While biased towards developed market equities, emerging market exposure is an important part of the fund's strategy. Thanks to a strong demographic tailwind, these markets offer higher growth and return prospects over the long term. There are many quality companies operating in emerging markets.

In selecting the most appropriate performance benchmark, we considered the substantial exposure that many leading developed market companies have to emerging markets. To reflect this changing opportunity set, we chose the MSCI ACWI for its larger exposure to emerging markets (12% to 13%), compared with the MSCI World Index, which only has 1% to 1.5%.

Global equities currently offer compelling value to South African investors. Large parts of the domestic market have run long and hard, and valuations appear overstretched. In contrast, we continue to find value in a number of selected global equities. ■

Rental market offering taken to a new level

BY LEON KOK

Sasfin Bank's recent acquisition of Fintech promises to be a major boost for Sasfin in the rental market in the period ahead. The R156m deal has received Reserve Bank and Competition Commission approval.

Sasfin provides rental, lease and instalment sale agreement services, particularly in the financing of office automation, and related equipment such as copiers, security, information and communication technology as well as capital equipment. This is generally referred to as the 'rental market'. Fintech operates in the same market with more than 10 000 commercial and corporate customers.

Sasfin's Business Banking division offers equipment finance as well as trade and debtor finance and is one of Sasfin's most successful divisions.

Says Linda Fröhlich, head of the group's Business Banking division: "The main driver is that Fintech

will provide us with an opportunity to strengthen our position in the market and deploy our capital more effectively.

"We anticipate good, solid, consistent growth during the next three to five years in spite of the current trying conditions experienced in the South African economy."

Three or four years ago, she explains, it had already become apparent that Sasfin needed a game changer, and in spite of scouring the market for opportunities, it failed to find a suitable partner.

Then the Fintech opportunity

presented itself. The company operates in the same fields, has similar business models, boasts excellent management and comparable cultures and is comfortably geared to the onerous regulatory requirements of the securitised space.

The Sasfin securitisation vehicle, the oldest in South Africa, was launched in 1991 and has grown from strength to strength since then. Ten years ago Sasfin's book stood at R300m and today is R3.4bn, with Fintech taking it to over R4bn.

Other big attractions that the deal has brought to Sasfin, says Fröhlich, is that Fintech is "lean and mean" and has two major clients, Bytes and Ricoh SA, entrenched on its platform. Consequently, its operations are spread across the country.

Sasfin and Fintech will look to boost efficiencies through the deal and will begin to operate under one brand in the near future. Glen Christopulo, Fintech CEO and a former shareholder, will continue his employment with the group.

"Their service levels are good, so are ours; their credit is very similar to ours; and there isn't a huge overlap in our businesses. They have similar products, similar offerings, but we play in different arenas," he explains.

Fröhlich says that Fintech's major rationale for the acquisition was that it needed a partner to help grow its business. "And that's what we do. We partner with you, get to understand your



Linda Fröhlich
Head of Business Banking at Sasfin

business, and help you grow to create wealth. A time, in fact, comes when smaller businesses need a bigger brother. And apart from all the other synergies, our reputation and balance sheet will allow Fintech considerably more operational and market latitude. Previously they could do deals of, say, a maximum R8m – now they have the platform to engage in much bigger deals."

Fröhlich says that ironically her division's last major growth phase was when financial markets collapsed in 2008. "Most banks saw fit to tighten up, and we believed that we were well placed to move into that space with our more conservative credit and slightly higher rates. Though the margins between us and them were small, we compensated with our very strong service ethic.

"People are people and they need a bit more love when things are difficult, and we played strongly to that. Your bank is your bank, but if it stands by you and helps you when you most need it, it takes the relationship to another level," she says. ■

**SASFIN
AND FINTECH**
WILL LOOK TO
BOOST EFFICIENCIES
THROUGH THE DEAL
AND WILL BEGIN
TO OPERATE UNDER
ONE BRAND IN THE
NEAR FUTURE.

Looking forward, looking back

BY LEON KOK

Allan Gray, one of South Africa's most outstanding asset managers, is set to remain firmly on course following the death of former chairman, Simon Marais, in February.

This emerged in a frank discussion with new chairman Ian Liddle, who has been chief investment officer (CIO) since 2008, and new deputy

CIO Andrew Lapping, who has been a portfolio manager since 2006.

Rob Dower will continue as chief operating officer (COO). He was appointed in June 2009.

Marais added considerable value to the group in his 24-year investment career. Apart from being non-executive chairman of the South African company, he spent two years as head of research in London with its sister company Orbis, and founded Allan Gray Australia.

YOUR COMPANY HAS BOASTED A GENERALLY EXCELLENT RECORD DURING THE PAST 30 TO 40 YEARS. WHAT HAVE BEEN THE MAIN ATTRIBUTES?

ANDREW LAPPING:

Considerable focus has been placed on finding the right people with the right skills who have a passion for the business. This has applied particularly to the appointment and training of associate portfolio managers and analysts, and the implementation of the right investment structures. When I take over from Ian next year, I hope to continue that.

We offer a simple suite of unit trusts, though from time to time we do look at new things when we feel that there is a need and it's in the best interests of our clients.

IAN LIDDLE:

We also continue to use the original investment philosophy introduced by our founder, Allan Gray, in 1974, which has worked well. It's been strengthened from time to time and will remain for a long time.

WHAT IS THE ESSENCE OF IT?

IL: Fastidiously placing clients first and consistently doing an excellent job

for them. This includes applying the best ways of investing and delivering the best long-term returns.

We try to establish long-term relationships with clients who believe in us and share our conviction in our investment approach.

We build mechanisms into the system that provide a powerful rationale for outperformance. The majority of our assets are managed on a performance fee basis.

Our business model and the way we reward and promote our staff are designed to encourage excellence. Our senior executives are shareholders in the business, aligning their long-term interests with those of our clients. All other staff receive a substantial portion of their remuneration in the form of performance-based bonuses.

Beyond that there is a very powerful institutional culture passed down over generations. It's difficult to pin down, but I guess it's a combination of the people you look for; the people you hire; and the people who choose to underpin and perpetuate it.

BUT GIVEN THE EXTENDED PERIOD THAT ALLAN GRAY HAS BEEN CONSISTENTLY NEAR THE TOP, THERE MUST BE MORE TO IT THAN THAT?

IL: Probably doing things right. We set extremely demanding and challenging standards, aiming to be the best in each area of our activities.

Another feature is that we have the courage to fly in the face of popular opinion. We value, seek and foster diversity of opinion and thought.

An element of luck has also been helpful at times. For instance, we launched our Equity Fund in 1998, which was right at the bottom of our performance cycle, with very good

Andrew Lapping
Deputy CIO
of Allan Gray



returns shortly after. Nothing like being at the right place at the right time!

HOW DO YOU AS AN INVESTMENT HOUSE DIFFERENTIATE YOURSELVES FROM YOUR PEERS?

IL: It's about delivering good returns and providing excellent service for our clients over the long term.

Allan Gray's Global Mandate share returns have overwhelmingly outperformed the FTSE/JSE All Share Index since 1974. Annual returns have generally been in excess of 20% a year, with best performances being 122% in 1999, 59% in 1985 and 1986, and 58% in 1989. The worst was -17% in 1997.

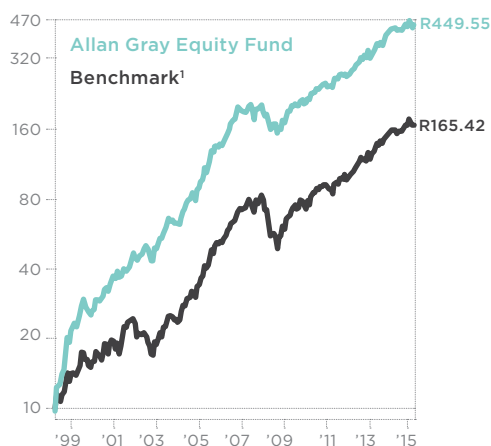
WHAT ABOUT UNDERPERFORMANCE?

IL: We know there'll be periods in which we'll underperform and it's important that our clients understand that, trust us, know what we're doing, and stick with us. It's about being transparent, communicating with them, and making clear that investing can be complex.

AL: It's important that our clients understand our long-term track record

PERFORMANCE NET OF ALL FEES AND EXPENSES

Value of R10 invested at inception with all distribution reinvested



1. The market value-weighted average return of funds in the South African – Equity – General category [excl. Allan Gray funds]. From inception to 28 February 2015 the benchmark was the FTSE/JSE All Share Index. [source: INET BFA], performance as calculated by Allan Gray as at 31 July 2015.

is established by both our investment philosophy and process, and that markets go through cycles – we've experienced many of these over time.

We are committed to 'bottom-up', fundamental research. In our experience, understanding companies and investing in them when they trade below their fundamental value is a more successful strategy than trying to predict economic, political or stock market trends.

One of the most important things in investing is what you don't own, so that when things go wrong, you don't lose money for your clients.

ALLAN GRAY IS OFTEN CRITICISED FOR SUPPOSEDLY SUBDUED PERFORMANCE BECAUSE OF ITS NOW CONSIDERABLE SIZE. YOUR VIEW?

IL: There is some validity to that. Looking forward, I doubt that our Equity Fund will be the number one performer during the next quarter or the quarter thereafter. Chances are that it will be a smaller boutique fund that'll hit a six with a concentrated portfolio. The reason behind this might be that it's much smaller and more agile than we are. But for every boutique that beats us, there will probably be at least another one that doesn't. What is important to us is to be considerably better than the average equity fund and slowly grow that differential over time. We aim to consistently make money for our clients over the long term.

HOW IS YOUR INVESTMENT TEAM STRUCTURED?

IL: The most significant feature is what we call a 'multiple portfolio manager system', where our funds are managed by a number of our portfolio managers.

Our internal system slices our portfolios, with each component managed by one portfolio manager. So the client gets the aggregation of the portfolios of each individual portfolio manager. This system allows for maximum accountability and considerable flexibility for succession.

Ian Liddle
Chairman of
Allan Gray



IS YOUR BALANCED FUND THE MOST SOUGHT-AFTER IN YOUR SUITE?

AL: Indeed, it's a very important fund for our investors. Something we watch very closely is the risk of loss. For some time we have considered stocks on the JSE to be pretty fully valued. The Balanced Fund allows us to reduce the exposure to overvalued asset classes and hold more cash or other fixed interest investments where the risk of capital loss is much lower. Holding cash affords us the optionality of being able to buy equities if valuations revert to more normal levels. ■

Passive solutions: More tools in the investing toolbox

BY BERNARD FICK

CEO OF PRUDENTIAL INVESTMENT MANAGERS



Bernard Fick
CEO of Prudential
Investment Managers

Index tracking or “passive” investments have become increasingly popular in the US and other developed markets over the past decade and are also gaining ground in South Africa.

According to global investment group BlackRock, approximately 25% of all US assets under management are now managed passively, compared to 13% in 2004, while in Europe about 11% is passively managed as opposed to only 4% a decade ago.

In South Africa, while the exact number is not known, the figure is much lower – approximately R124bn is invested in exchange-traded funds (ETFs), most of which track indices, compared to over R1.7tr in unit trusts

that are mainly actively managed.

WHAT ARE INDEX TRACKING FUNDS?

Index tracking funds aim to produce returns that are in line with the average return of a market index, such as the FTSE/JSE All Share Index (Alsi). They simply buy all of the underlying shares in the index according to the index weighting, and use automated trading programmes to regularly re-weight the portfolio, reflecting the price movements of the shares over time. It is important to point out that actual investor returns in an index tracker must, by definition, be lower than the index returns due to trading and administrative costs, plus management fees. Tracking error also plays a role.

THE PROBLEM WITH MARKET CAPITALISATION INDEX TRACKERS

If a passive fund tracks an index based on market capitalisation, it buys more exposure to the largest and most expensive companies in the index as prices rise, and sells as prices fall. This approach is considered fundamentally flawed by valuation-based investors like Prudential, which focus on buying those companies offering the best value.

Passive product providers have consequently developed a wide variety of funds that can track more sophisticated benchmarks. These are often described as “smart beta” or “enhanced indexation” products, since they aim to provide a way of beating the market capitalisation index.

The choice of bespoke index tracking funds has multiplied rapidly. In SA, we have nearly 50 different ETFs listed on the JSE with exposure to commodities, property, currencies, high-dividend paying companies, among others... and a large number of unit trust tracker funds. The selection of the appropriate benchmark to track is a significant decision, and blurs the line between passive and active investment management.

WHY CHOOSE INDEX TRACKING FUNDS? COST VERSUS PERFORMANCE

Very often investors choose passive solutions because they are primarily concerned about the costs of investing. Passive fund management fees can be as low as about 0.3% to 0.4% p.a. in SA (and even lower in the US), but are more commonly found around 0.6% p.a. or higher. To this other costs must then be added, like trading fees.

Smart beta solutions tend to be somewhat more expensive due to their more sophisticated management approach.

Actively managed funds, meanwhile, are generally more expensive, with management fees of typically 0.6% to 1.3% p.a. This is because these managers aim to outperform the benchmark by analysing and selecting stocks whose performance is expected to be better than average over time. This makes the costs of providing actively managed funds higher than those of passive funds.

However, passive funds are not always cheaper than active unit trusts, so investors need to check all costs carefully. In essence, the issue comes down to this: Can the actively managed funds provide a better return and risk outcome than a passive product, after allowing for the additional costs involved?

IS ACTIVE MANAGEMENT WORTH IT?

In highly efficient markets like the US, it has proven difficult for active managers to beat the average index performance consistently over time – only a handful of managers have been able to do so. At the same time, it is difficult to choose those winning managers based purely on their past performance, since this can change from one year to the next. As a result, some investors have turned to index trackers as a practical way to earn cost-effective returns over time.

Financial advisers have also increasingly opted to recommend passive strategies to clients. Besides the cost argument, passive products have become the safer option to recommend to clients for regulatory reasons. In markets like SA, the case for passive is less clear-cut, given that our markets are smaller, less efficient and less well researched. At Prudential, we believe that short-term market inefficiencies give rise to

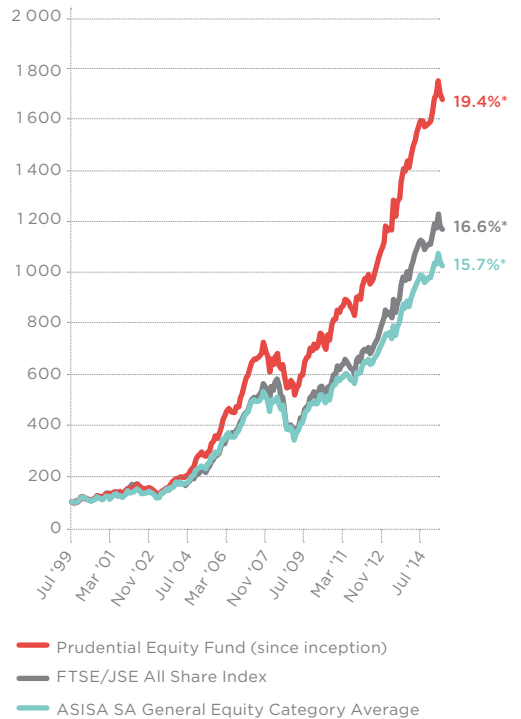
the mispricing of assets and create opportunities for fund managers to produce above-market performance. A handful of established asset managers, including Prudential, have proven themselves able to outperform market indices over long periods of time, net of fees. Looking at the long-term

performance of our client portfolios (Prudential Equity Fund is used as an example in the graph), we can demonstrate significant outperformance, both of the All Share Index and most competitor funds. This is after all fees. We certainly believe active management has been worth it for our clients.

WE ALSO USE PASSIVE SOLUTIONS

At Prudential, we recognise that there are markets whose characteristics make it difficult for managers to add sufficient

Prudential Equity Fund outperforms Als, after fees



*Annualised return, after fees

value to justify the additional cost of an active approach. For us, South African listed property is just such a market. Consequently, we offer the Prudential Enhanced SA Property Tracker Fund, which has a “smart beta” approach, further enhanced by active analysis and portfolio management.

There are also instances where we use foreign ETFs in the global component of some portfolios in order to gain easy and cost-effective exposure to offshore markets like US equities in implementing our active asset allocation strategies.

WHAT DOES THE FUTURE HOLD?

We believe there is a role for both passive and active investments in investor portfolios – both are valuable tools in the wider investment toolbox. The most important consideration for an investor is that the chosen solutions should deliver what they promise, so that the investor can successfully meet their goals. ■

Investment opportunities in infrastructure

BY GILLIAN JONES, HEAD OF STANLIB THOUGHT LEADERSHIP AND PERFORMANCE COMMUNICATION, AND GREG BABAYA, HEAD OF INFRASTRUCTURE FRANCHISE AT STANLIB

Traditionally, infrastructure has been funded by the public sector. But the size of the infrastructure deficit has become far too large for governments alone to finance. Following the 2008/09 global financial crisis, governments have amassed huge debt, making it even more difficult for them to raise the necessary funding to maintain existing infrastructure and build new projects. As a result, the private sector is increasingly finding opportunities to invest in infrastructure programmes.

In South Africa, the department of energy's Renewable Energy Independent Power Procurement Programme (REIPPP) has been a successful example of a large-scale private and public sector procurement programme to develop much-needed infrastructure.

To just keep up with projected global economic growth, about \$57tr is needed for infrastructure investments up to 2030, according to a 2013 McKinsey report, *Infrastructure productivity: How to save \$1 trillion a year*. This is 60% more than the \$36tr that was spent globally on infrastructure over the past 18 years.

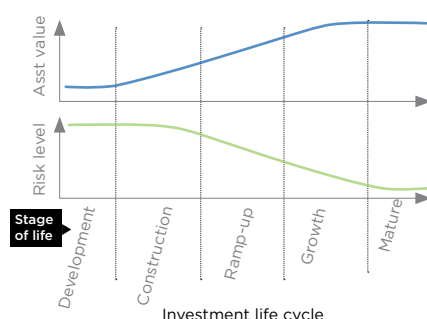
Africa's infrastructure gap is even wider, according to McKinsey. SA's relatively immature market has fantastic growth potential, while this is even more relevant in the rest of Africa with its massive infrastructure deficit.

This landscape creates an attractive opportunity for investors wanting to diversify the risk in their portfolios. Fund managers globally are reporting an increase in investor appetite for infrastructure deals, particularly from pension funds, insurance companies and sovereign wealth funds, according to Preqin, a leading source of intelligence on the global infrastructure market.

In terms of infrastructure deal flow,

Investing in infrastructure

Valuation and risk



Value drivers:

- Cash flow
- Discount rate
- Interest rates
- Risk

Issues to consider:

- Long lead times
- High transaction cost
- Attention to detail required
- Illiquid

Europe is the most prominent market. According to Preqin's 2015 *Global Infrastructure Report*, European assets account for a higher proportion of deals completed per year than any other region. This can be attributed to "the long history of private sector investment in European infrastructure and the largely stable economic, political and regulatory environment in Western Europe, where most European transactions take place".

Europe's trend illustrates that transparent, competitive environments overlaid with balanced regulatory frameworks give investors the confidence to increase their exposure to infrastructure.

Development in Africa has been slow but steady and we expect the continent will start to follow Europe's lead and echo its success. Once investors start to understand how the private sector can play a role in infrastructure investment, the markets will pick up.

According to Preqin: "The attraction of infrastructure is evident to most institutions. We see the potential for it

becoming a significant mainstream asset class for the majority of institutions with a long-term mandate, in the same way as private equity."

Recognising the growing role of private sector funding in infrastructure, Stanlib has introduced two funds to capitalise on the opportunities. This aligns with Stanlib's commitment to finding investment opportunities that are part of the solution to Africa's greatest challenges.

Stanlib's Infrastructure Private Equity Fund invests in new-build infrastructure projects, the majority of them in SA. Its investments include R813m in REIPPP wind and solar projects that have a collective nameplate generation capacity of 345MW and are expected to contribute approximately 847 395MWh per year into the national grid for the next 20 years. This is equivalent to powering 192 590 average SA households (using the World Energy Council's data).

Our Infrastructure Yield Fund focuses on more mature infrastructure assets, investing in post-construction, operational infrastructure projects. Once projects are built and have an operational track record, they have a different risk profile: they have highly predictable revenue profiles and provide a good measure of diversification in a general portfolio.

Infrastructure is ideally suited to investors looking for alternative assets with predictable risk-return profiles. It offers benefits like stable returns with low volatility. Its low correlation to the business cycle adds diversification to an investment portfolio and offers a good inflation-hedge, as the income streams are usually inflation linked.

We expect that Africa will heed the lessons learnt in markets that have been successful and embrace the participation of the private sector. ■

Dealing with currency distress

BY LEON KOK

Perhaps the most dominant theme in our recent series of interviews with asset managers was the rand, and the general threat of currency wars.

General responses regarding record rand lows were negative, with some desperate to hedge portfolios against a sinking rand. On the other hand, another analyst was less concerned, arguing that the US dollar is on steroids and should be seen in isolation.

However, consensus was that rand weakness will continue, at least for the medium term. Figures bandied about indicate a worst case of R14.50/\$ in a year's time and R16/\$ in two years' time.

Much of this, it was agreed, will be a function of political mismanagement and slow economic growth in SA; China's latest game changer on currency; and disturbing trends in emerging markets generally. Turkey and Brazil, for instance, have been cited as worse off than SA.

Old Mutual senior economist, Johan Els, was more conservative than most, telling us that Old Mutual's MacroSolutions division's guestimate for the rand/dollar exchange rate at year-end is R12/\$ for both this year and next.

Despite the ghastly hand the Reserve Bank and Treasury have been dealt, the Investec Income Team was highly praiseworthy of both. However, it conceded that the Reserve Bank sees its role as combating inflation, not defending the currency. Els was most concerned about the latest Chinese devaluations' potential of exporting deflation into the global economy, and, as a consequence, driving commodity prices down, directly affecting SA's economic performance.

On the other hand, Els suggested that the situation could also be stabilised by a strong Chinese stimulus. "Perhaps China has already had its 'hard landing', with growth having declined from an average 10% previously to around 7% now. It still has considerable capacity to stimulate its



CONSENSUS WAS THAT
RAND WEAKNESS
WILL CONTINUE,
AT LEAST FOR THE
MEDIUM TERM.

economy via a fiscal package," said Els.

My former colleagues at Fleet Street Publications (FSB) in London are more wary of that view. They insist that China's economy is in serious trouble and that the devaluations are a means of 'stealing' quality growth from elsewhere; and in addition as a sop to be included in the IMF's special drawing right. The IMF, in fact, has given China a B+ for its efforts.

US Democratic Senator, Chuck Schumer, has argued that "allowing the

yuan to be declared a reserve currency is akin to putting the fox in charge of the hen house".

The question arises nevertheless: how do you and I hedge against a collapsing rand?

Looking back three years – and a credit to the fund industry – you ought to have done reasonably well if you'd invested in the better funds.

Among the best would have been the Orbis SIVAC Japan Equity Fund that generated an annualised 45.71% over three years. On its heels were the Investec Global Strategic Equity 34.41%, Orbis Global Equity 33.91%, Coronation Global Equities 32.11%, Standard Bank Strategist M-M Global 31.18%, and Stanlib Global Equity 30.25%.

Among more moderate global asset allocation funds, the Coronation Global Managed Fund would have given you 27.33%, followed by – among others – Investec Global Strategic Managed 26.16%, Stanlib Global Aggressive 26.3%, and Orbis Optimal 18.67%.

Global fixed interest would have given you between 11% and 15%, while you would have earned a respectable average 24% from leading global real estate funds.

For those who are extremely bearish about the currency, several important lessons come from Latin America. I travelled extensively there during the extremely volatile 1990s and most prominent hedging avenues were the hoarding of hard currencies, investing in good property, and capitalising on gemstones and collectibles.

It's no coincidence, for instance, that San Telmo in downtown Buenos Aires is one of the finest antique markets in the world.

SA, of course, is still very different from Latin America, but we are becoming more like it. Some of the strategies and tactics people use there will become increasingly valid for us in the future. ■

RCL Foods restructure pays off through dividend boost

BY JACO VISSER

The Rupert family's food production venture, RCL Foods, has restructured its underlying businesses following a number of years' aggressive acquisitions and recalibration of Remgro-owned units. Now the company will focus on growing its brands and doubling up its expansion into the rest of Africa, CEO Miles Dally tells *Finweek*.

A deep restructure at South Africa's second-largest food producer by revenue, Durban-based RCL Foods, recently paid off to investors who received an 85% higher dividend than the previous year.

RCL Foods, which started off as Remgro-owned Rainbow Chicken Ltd, acquired privately-owned Foodcorp Ltd and Remgro's sugar-production assets, TSB Sugar, over the past couple of years. A plethora of deals, which included redenominating Foodcorp's high-yield euro bonds into a local rand funding deal, rights issues and the acquisition of Vector Logistics, set the company up as the undisputed competitor of Tiger Brands, the groceries behemoth.

RCL Foods generated R23.4bn in sales in the 12 months to end June. This was 4.5% higher than the *pro forma* sales of the previous year, which included,

among others, a full year of sales at TSB Sugar, according to its latest results.

The company is now split into three units. Under its Consumer unit falls most of Rainbow Chicken and Foodcorp. TSB, Foodcorp's milling and baking division, as well as Foodcorp's and Rainbow Chicken's animal feed units fall under Sugar and Milling. The third unit is Vector Logistics, which ensures that produced goods get to the consumer.

"We told the market we're not going to run as a holding company," CEO of RCL Foods, Miles Dally, says. "But we needed time to assess all the new leadership teams that we had."

POULTRY

RCL Foods' Rainbow Chicken brand has always focused on quick-service restaurants (QSRs) with large supply agreements with brands such as KFC

and Nando's, according to Dally. As the dumping of chicken increased over the years, mainly from EU countries, smaller local suppliers started falling off the bus. A recent trade agreement with the US will see a further 65 000 tons of bone-in chicken arrive in SA without anti-dumping tariffs.

"We need to be clear about this, it is dumping," Dally states. Consumers in the EU and US prefer the white meat, or breast, of the chicken with the so-called brown meat exported to other countries such as SA.

Poultry producers in the EU and US are profitable by only selling the white meat; the brown meat accounts for pure profit no matter at which price they sell it, he says.

The SA Poultry Association, which is the umbrella organisation of domestic poultry producers, recently put up a fight, with the backing of minister of trade

A PLETHORA OF DEALS SET THE COMPANY UP AS THE **UNDISPUTED COMPETITOR** OF TIGER BRANDS.

RCL Foods, which owns TSB Sugar, has restructured its divisions following a period of aggressive acquisitory growth.

GETTING TO KNOW MILES DALLY

Q: What book did you read last?

A: I finished Malcolm Gladwell's *David and Goliath*. It's all about the advantage of disadvantage and the disadvantage of advantage. It really strikes a chord with me. If you look really simplistically at it, you have poor kids in life who battle and rise to the top. At the same time, if a kid is in a private school it doesn't necessarily mean he or she is guaranteed success. I've seen that in my whole career where we employ people with values and a passion for what they do. I don't look at whether that person was the headboy or headgirl at a school, for example.

Q: What is your favourite vacation spot?

A: The Umngazi River Bungalows near Port St Johns in the Eastern Cape.

Q: What sports do you watch and which teams do you support?

A: I support Manchester United in football and the Sharks in rugby.

and industry Rob Davies, to limit the anti-dumping duty-free imports of US chicken.

"All that we're asking is a level playing field," Dally says. "South African producers are efficient and profitable in supplying the local demand."

Rainbow Chicken increased its sales by 3.9% in the previous financial year to R9.1bn. The move away from individually quick-frozen (IQF) to focus more on QSRs saw its earnings before interest, depreciation, tax and amortisation (EBITDA) jump 286% to R773.9m.

SUGAR

The sugar division escaped the impact of the drought in KwaZulu-Natal as most of TSB Sugar's 1 600 farmers have irrigation systems. The company benefitted from lower imports as an increase in the import duty on sugar was triggered by a drop in international prices.

Nevertheless, TSB Sugar's more than R1bn greenfield cane development project in Massingir in Mozambique struggled to find a funding partner by the 30 June deadline selected by the board and the company took an R84m impairment on the project.

"The board was concerned about the scale of the Massingir project and we wanted a partner," Dally says. "The project is not dead, it is just impaired."

The sugar division, which counts Selati as one of its brands and houses animal feeds manufacturer Molatek,

increased its sales to R6.1bn from R5.4bn while EBITDA jumped almost 45% to R505m.

OTHER UNITS

The higher revenue at the chicken and sugar divisions wasn't repeated at grocery maker Foodcorp. Sales declined by 0.4% to R7.5bn while EBITDA rose 3.9% to R743m.

This division's sales growth was hampered by the pie unit, Pieman's, which lost a key customer, Corner Bakeries. In response RCL Foods changed leadership and refocused the unit to be more innovative in its products and also more consumer-centric, according to Dally.

The milling and baking division, which owns brands such as Tafelberg maize meal and Sunbake bread, also saw a change in leadership and sales volumes have started to pick up again, Dally says.

Vector Logistics, which is the group's route-to-market division, increased sales by 10.8% to R1.88bn while EBITDA rose 4.4% to R206m.

"Vector was a good investment," says Dally. "It manages the supply chain for a number of QSRs, including Nando's and Chicken Licken." The division now employs more than 2 000 merchandisers in retailers across the country, he says.

The company's plants, especially the sugar mills, co-generated about 223.8GWh of power in the previous financial year, a 10% increase on 2014. ■

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Miles Dally
CEO of RCL Foods



IMPALA PLATINUM



Managers didn't heed cyclical nature of industry

BY SIMON BROWN

THE TROUBLED STORY of the mining sector is well known. Commodity prices are under pressure while costs are rising. The Impala Platinum (Implats) share price has been under serious pressure, having just recently traded under R40 for the first time since 2001 after trading at almost R400 in 2008.

The recent announcement of a book-build to raise R4bn initially spooked the market. With a market cap of around R28bn, it's not overly massive, but it raises two concerns.

Firstly, the company is selling shares

at 14-year lows. This is the boom-and-bust nature of mining, but a smart management team would anticipate the bust years during the boom and put some money aside for when they come.

The other issue is what price the shares will be issued at. Implats has not announced this as it's a book-build, so those looking to buy submit prices. However, the underwriter, UBS, is underwriting at around R23 a share! That's an ouch price and suggests what it's prepared to pay for the shares. ■

Simon Brown Last trade ideas

BUY Metrofile

BUY TOPSBT

BUY Mondi

SELL Kumba Iron Ore

STEINHOFF INTERNATIONAL



Making all the right moves

BY MOXIMA GAMA

STEINHOFF, WHICH SELLS furniture to lower-income customers in Europe and Africa, and whose local assets include Pepkor and retail brands like Incredible Connection, Joshua Doore and Bradlows, is a stock market darling. All nine investment analysts polled by the *Financial Times* predicted that the company will outperform the market. Steinhoff, with a market capitalisation of more than R296bn, has jumped from R25 per share in 2013 to levels above R80.50 this year, offering shareholders a stellar return.

To entice stakeholders further, Steinhoff is planning to move its primary listing to Frankfurt in December, which will make it easier to access global capital markets. It will retain a secondary listing on the JSE.

It's potentially a good move, since Steinhoff earns more than half of its revenue in Europe (it is the largest retailer in Europe after Ikea).

By exposing itself to institutional shareholders in Europe, it will be able to

raise capital more easily and cheaply. The move also enjoys firm shareholder support. However, over the past five months, Steinhoff has struggled to trade above R80.50, even consolidating between R80.50 and R71. This is despite clinching discount clothing retailer Pepkor from private equity firm Brait for R62.8bn last year in South Africa's largest corporate transaction to date. Even though Steinhoff has a strong balance sheet, entrepreneurial management and an enviable market positioning that's appealing to investors, failure to trade through R80.50 could mean it has reached a ceiling – a sign of exhaustion. If so, Steinhoff would be too expensive to enter at current levels.

It's highly likely that the company will surge as it overcomes the R80.50 major resistance level, potentially reaching the R90 level. Failing which, alarm bells should sound, and a short should be initiated below R70. ■

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Moxima Gama Last trade ideas

BUY Datatec

SELL Aspen Pharmacare

SELL Naspers Limited

BUY Telkom SA

Guarding against rand weakness

BY JACO VISSER

CONSILIUM BCI FLEXIBLE FUND

The fund aims to provide investors with long-term capital growth and a reasonable level of income, according to its latest fund fact sheet. The fund's underlying investments are skewed towards South African

equities, followed by local cash, offshore equity and local listed property. Some of the largest holdings include Nedgroup Investments' Money Market Fund, Naspers* and Discovery.

FUND INFORMATION

Benchmark:	CPI + 5%
Fund manager:	Consilium Asset Management
Total Expense Ratio (TER):	2.49%
Fund size:	R47.6m
Minimum investment amount:	R10 000 lump sum or R500/month
Contact information:	011 340 1300

PERFORMANCE (ANNUALISED) AS AT 31 JULY 2015:

	1 year	3 years	5 years	Since inception in January 2007
•Consilium BCI Flexible Fund	16.27%	22.48%	20.26%	14.4%
•Benchmark:	9.97%	10.9%	10.68%	11.67%

TOP 10 HOLDINGS (AS AT 30 JUNE 2015)

1.	Nedgroup Investments Money Market	7%
2.	Naspers	5.2%
3.	Discovery Holdings	4.9%
4.	PSG Group	4.7%
5.	Datatec	4.5%
6.	Steinhoff Investment Holdings	4.1%
7.	Zeder Investment Holdings	3.8%
8.	Telkom SA	3.7%
9.	Michael Kors Holdings	3.6%
10.	Standard Bank Group	3.3%



Fund manager insights

THE FUND PREFERS to invest in shares where the balance sheet carries little debt and has a strong cash flow, according to Jacques Pretorius, a fund manager at Consilium Capital.

"There aren't a lot of areas where you can find value in the domestic market today," he says. "We don't see growth on a broad base."

As the local interest rate cycle starts to rise in the run-up to a potential monetary tightening by the US Federal Reserve amid increased economic activity, local financial shares may be worse off.

"There will be increased pressure on local financial and industrials assets, especially on consumer and retail stocks, as the interest rate increases," Pretorius says.

With regard to the fund's top stocks, Pretorius likes Datatec as the stock is a rand hedge that generates most of its income offshore. The fund also invested in PSG Group during March and took profit on over the last month, according to him.

"The fund has now turned to invest in PSG's underlying assets, such as Zeder," Pretorius adds. He sees Zeder, which is majority-owned by PSG and invests in agricultural assets, as a defensive stock due to its large holding in Pioneer Foods.

WHY FINWEEK WOULD CONSIDER ADDING IT

The fund is skewed towards stocks with a strong cash flow and a number of them earn their revenue offshore. As the rand is still weak, and may carry on devaluating in light of a potential increase in US interest rates, this fund offers protection against local currency weakness. The fund's large allocation to cash may be a drag on returns, but gives it the flexibility to move in and out of positions quite quickly. ■

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*Finweek is a publication of Media24, which is a subsidiary of Naspers.



Don't be spooked by short-term market moves

BY SIMON BROWN

As human beings we're not very good at managing or understanding risk, this is because our primal instinct is fight or flight. We want to either hit it or flee from it, but our response to risk needs to be much more nuanced. One example of the way we manage risk badly is that many of us buy the stock market at the top and sell it at the bottom for the simple reason that it feels right. Buying at highs seems right because things are going up and everybody is excited, while selling at the bottom seems right because things are collapsing and people are gloomy. Yet we know that the inverse is the right course of action – buy at the lows when everybody else is fearful.

Our mismanagement of risk was further driven home for me last week when I had a meeting with a 28-year-old who revealed that her entire investment portfolio (and a chunky one of around R100 000) is invested in money-market funds. When I asked her why, she said the stock market was dangerous and friends of hers had lost money. Both statements are correct, but she missed the main point of investing: time. At 28 years old, she has almost 40 years until retirement and in that time the stock market will crash at least four times, maybe more. But even with those four crashes her investment will show significant growth, beating inflation and other asset class returns, resulting in real wealth creation.

We're overly fearful of market crashes and/or corrections. Yet they're fairly common. Data from the S&P 500 shows that a 10% correction happens on

average every year, a 20% correction every three to five years while a 30% to 40% correction (crash?) happens about once a decade. The monster 50% correction has only happened twice in the last 100 years.

So not only are they fairly common, but the market still offers inflation-beating returns over time in spite of these market corrections.

I still clearly remember my first share purchase on the JSE, it was October of my matric year and I bought a few hundred rand of DiData.

MARKETS ARE DANGEROUS, BUT IN REALITY THAT ONLY APPLIES TO THE SHORT TERM – OVER THE LONG TERM THEY ARE THE BEST WAY TO CREATE WEALTH.

The problem was that the year was 1987 and a week later we had a real market crash as the Dow Jones shed over 22% in one day, now called Black Monday.

At the time it freaked me out, but my grandfather, who'd been teaching me about stock markets, laughed, pointing out this was going to be the first of many crashes I would experience and I should get used to it.

He was right.

I have since witnessed the 1998 crisis, the dot-com bust and most recently the 2008/09 global financial crisis. That makes four in just under 30 years.

More importantly, if instead of DiData I had bought the index – we didn't have exchange-traded funds (ETFs) back then and the index would have been the All Share – I would have paid under 2 000 points and today it is almost 50 000. This massive wealth creation excludes dividends that would have significantly increased my returns.

So, sure, markets are dangerous, but in reality that only applies to the short term – over the long term they are the best way to create wealth. If we have time on our side, we should use that time by investing in the market (invest simply using ETFs) and create real wealth for ourselves. The short-term moves will be noisy and scary, but ignore them, focusing instead on the long-term wealth creation aspect of the market. ■

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Is there still gas in Sasol's tank?

BY MOXIMA GAMA

Despite the massive drop in the price of Brent crude oil, which is down to below \$50 from more than \$100 a barrel a year ago, I believe it's a good time to buy Sasol.

While prices are expected to remain under pressure in 2016 – Vitol Group, the world's largest independent oil trader, is predicting \$40 to \$60 a barrel into next year due to oversupply in the market – Sasol continues to perform well operationally. The petrochemical group, whose share price is down more than 30% since its peak in June 2014, has grown liquid sales volumes by 5% to 61.5m barrels in the year to end June, conserved cash to the tune of R8.9bn in the first six months of the year, and realised cost savings of about R2.5bn, that is R1bn more than planned.

The cost savings formed part of Sasol's restructuring, which saw 2 500 employees take early retirement or voluntary retrenchment packages and led to a simpler business model. Implemented in 2012, CEO David Constable said at the time the plan aimed to "fix the roof while the sun was shining". Ongoing

cost savings of at least R4.3bn a year (compared with 2013 numbers) are targeted by the end of the 2016 financial year. Overall, the group reported a 17% decline in headline earnings per share, leading to a 14% cut in its dividend for the year to R18.50 (also see page 14). On average, Brent crude prices were down 33% for the financial year to end June, compared with the previous year.

Its chemical operations were the star performer, with base chemicals (products like fertilisers and polymers) growing profit from operations by 51% to R10.2bn, and performance chemicals (which include wax) improving 7% to R12.7bn. Its Exploration and Production International (EPI) business, which includes its Montney shale gas assets in Canada and gas assets in Mozambique, cut its losses to R3.17bn from a loss of nearly R6bn in the previous financial year.

The future seems bright for Sasol, as management remains meticulous and resolute. Despite putting a few projects on ice, it remains on track to complete

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EVERY FRIDAY
AT 1PM.

its \$8.9bn ethane cracker in Louisiana in the US in 2018, and also plans to expand production in Mozambique.

However, one needs to keep a close eye on the oil price in rand, which is the most important driver of Sasol's earnings. To put it into perspective; a 10c move in the rand against the dollar over a year can affect the bottom line by R650m. Going forward, Sasol should be a good investment, provided that the rand oil price remains close to, or exceeds, R600 a barrel. In addition, it's outperforming all its peers on the Resi10 Index.

POSSIBLE SCENARIO: Sasol is potentially forming a double-bottom pattern at R360/share, which would be confirmed above R500/share. It recently breached the resistance trendline of its short-term bear trend (formed within its huge consolidation pattern), and upside above R455/share would make a good entry point. However, this position should be revised at R500/share, as Sasol has encountered resistance there before. Otherwise, continued upside would warrant an aggressive reload above that level, as upside to the objective of the double-bottom pattern at R640/share would be possible.

ALTERNATIVE SCENARIO: Medium-term consolidation would persist below R383/share. However, support must hold at R360/share, or else Sasol could fall to the downside target at R220/share. ■

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SASOL



52-week range:	R360 - R645
1-year total return:	-31.47%
Current P/E ratio:	8.55
Market capitalisation:	R277bn
Earnings per share:	R49.76
Dividend yield:	4.35%
Average volume over 30 days:	1 686 563

SOURCE: Bloomberg.com

Simon's stock tips

BY SIMON BROWN

DISAPPOINTING UPDATE FROM MR PRICE

Starting with trading updates, Mr Price* issued what the market considered a shocker of an update that sent the stock



down 13% at one stage on the day. Total group sales growth was 9% with same-store growth only 4.6%. This is not out of line with other retailers, but for the highflying Mr Price it was simply not good enough. The statement did mention a few issues such as the fact that Easter was early this year and that sales over this time were included in the previous period. The retailer also made some bad fashion calls. That all said, when the share price peaked in April at over R280, the price-to-earnings ratio (P/E) was around 33 times. This reminds me of Shoprite*, which had a similar P/E when it peaked at around R220 in early 2013. The Shoprite price has been weak ever since, while earnings slowly catch up to that elevated P/E. The same fate will likely befall Mr Price unless it can get growth roaring again.

AVENG STILL LOST IN THE WOODS

Aveng has announced the sale of 70% of its property portfolio for just over R1.2bn. This helps the company a bit as it provides a chunk of cash (the amount is around half its market cap) but it doesn't get it out of the woods. It will now have to lease back the properties at a cost, and that R1.2bn is only slightly higher than its operating free cash outflow for the last reporting period. This also comes on the back of a R1.5bn convertible bond it issued in the middle of last year, showing just how cash-intensive the industry is and how tough the current conditions are. The bottom line here is that the company is struggling and this move will not save it – it will merely ease the pressure for a short while.

CAPITEC EARNINGS OUTPACE HISTORIC P/E

We got a decent trading update from Capitec* with HEPS for the first six months expected to be 22% to 26% higher. Considering that the stock has a historic P/E of just over 22 times, this is exactly what you want to see – earnings growing faster than the historic P/E. It not only justifies the high P/E, but will also see it reducing when the results are published as the earnings part of the P/E will increase, reducing the overall ratio.

INDEX CHANGES ON THE JSE

The JSE announced the index changes that will be effective 21 September. Kumba is exiting the Top40 and moving into the MidCap Index to be replaced by Redefine. Exiting the MidCap are Illovo, Lonmin and Royal Bafokeng Platinum. The trend we've seen over the past few years continues as resource stocks see their market caps continually shrinking. Illovo is the odd one out, but its drop is not surprising – I have been cautioning against investing in the sugar industry for some time as global sugar prices come under pressure.



COMMONWEALTH GAMES BRING NO IMMEDIATE GAINS

Durban has won the right to host the 2022 Commonwealth Games and many are looking for the investment opportunity as we did with the 2010 Fifa World Cup. Construction is not an option as most of the infrastructure is already in place, with only a few temporary facilities

needed. Hospitality will do well but it will be localised around Durban for the few weeks of the event. Sure they'll do well, but I'm not sure it'll be enough to really move the dial. In short, the winner will be longer-term awareness of Durban and South Africa. There will be one big

winner, Airbnb. This will help locals rent out rooms and if anything, will dent hotels' income. Since we're unable to invest in Airbnb, I'll just be a spectator. ■

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**The writer owns shares in Capitec, Shoprite and Mr Price.*

Bidvest: Diversification protects against risk

BY SHAUN MURISON
Market Analyst at IG

Bidvest, the international services, trading and distribution company with a global footprint extending to five continents and a market capitalisation of nearly R106bn, has once again reported a robust set of results for the year to end June.

The group's operations consist of four key divisions, namely: Bidvest South Africa, Bidvest Namibia, Bidvest Foodservice and Bidvest Corporate. Announcing its results at the end of August, it said all four divisions have managed to grow turnover over the last reporting period, with the two largest divisions – Bidvest Foodservice and Bidvest South Africa – posting the most substantial revenue gains of 14% and 9.2% respectively.

Bidvest Namibia and Bidvest Corporate posted more modest revenue

growth of 2.5% and 6.5% respectively. The diversification of the Bidvest portfolio provides a defensive hedge against industry specific risks, while the geographic diversification reduces the impact of currency risks. In the last reporting period, the standout performance was realised by the Foodservice division.

Bidvest Foodservice – which supplies food, equipment, liquor and non-food items like cleaning materials and packaging to customers around the world including coffee shops, restaurants, hotels, airlines, mines, prisons and hospitals – accounts for just over half of the group's turnover, while contributing more than 40% to the group's trading profit. Within the division, a sluggish performance from the emerging markets geographies was more than offset by impressive growth

particularly in the European and the UK businesses, which have seen trading profit surge by 57% and 42% respectively.

Bidvest SA, which contributed just over 40% to group revenue and just over half to the group's trading profit, has shown resilience as the division continues to grow despite the economic headwinds currently in place.

Ten of the 11 South African operations achieved turnover growth while only the smallest contributor to revenue, the consumer products division, showed contraction.

Overall, headline earnings per share for the year to end June were up 8.6% to R18.82, while group turnover grew 11.6% to R204.9bn. A final dividend of R4.82 a share was declared.

Bidvest trades on a historical price-to-earnings ratio (P/E) of 16.5 times, while offering a dividend yield of around 3% per annum and generating a return on equity just short of 20%. The management of the business, led by Brian Joffe, has proven its efficacy in achieving both organic growth and acquisitive growth year after year.

The current market volatility is likely to result in further opportunity and in turn strategic acquisitions for the group. If past performance is any indication of future performance, then this should serve to further enhance the scope, reach and earnings potential of the business going forward.

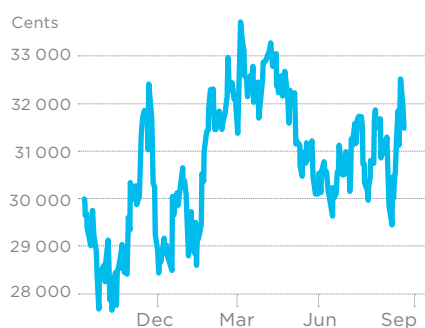
For those market participants looking for an investment which has proven consistent growth in the past, offers a fair yield, while providing a partial currency hedge and a diversification inherent of itself, the Bidvest Group warrants consideration. ■

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Brian Joffe
CEO of
Bidvest
Group

Bidvest Group Ltd



52-week range:	R272.57 - R338.69
1-year total return:	+8%
Current P/E ratio:	16.84
Market capitalisation:	R106bn
Earnings per share:	R18.82
Dividend yield:	2.87%
Average volume over 30 days:	800 235

SOURCE: Bloomberg.com

Drawing up a **budget** is not a one-off process

BY SCHALK LOUW

Portfolio Manager at PSG Wealth

In Greek mythology, Sirens were mythical creatures that lived on an island and lured sailors to their doom through enchanting songs. Sailors, who could not resist the temptation of the Sirens' song, helplessly wrecked their ships on the island's rocks.

Personal finance works roughly the same. We all know that debt is a bad thing and that we should always remain within our personal income limitations. Yet the temptation of easy loan availability makes it as hard to resist as the Sirens' song.

But the story continues.

Orpheus, a talented and charming musician was called in by the Argonauts to assist them on an expedition that would lead them past the notorious island. As they approached the island, Orpheus heard the Sirens' voices, immediately took out his lyre and started to play. Thanks to his music being louder and more beautiful than the Sirens' song, the crew managed to sail past the island safely.

In personal finance, the lyre is nothing other than a well-planned budget. The trap that most people fall into, however,

is convincing themselves that they can stick to their budgets by memorising them. Surely the need to formally draft a budget is redundant? Unfortunately, you are fighting a losing battle if this is your way of thinking.

A personal budget is fairly simple to set up and shouldn't take more than 15 minutes a week to update. Always remember; if you can measure it, you can manage it.

HERE IS MY 15-STEPS-IN-15-MINUTES BUDGET PLAN:

1. Preferably start with a blank Excel spreadsheet, or a columned sheet of paper.
2. Categorise your expenses by carefully working through the past week's bank transactions or bills.
3. Do not forget to include your hobbies and other expenses, they also have to be categorised.
4. Any form of income that flows into your account has to be indicated clearly in order to determine your total average monthly income.
5. Remember that saving comes first and not after your expenses have been covered, so be sure to set a fixed amount aside on a monthly basis. Also ensure that you have a separate savings facility at your disposal.
6. Keep in mind a realistic target amount, in each expense category, by which you would like to cut your expenses in an attempt to save more.
7. Once satisfied that all possible categories have been covered, start capturing the data on your piece of paper or spreadsheet.

8. Take note of cash withdrawals and be sure to indicate them clearly on a weekly basis.
9. Calculate the subtotals of your income and expenses.
10. Subtract your total expenses from your total income to calculate your net income.
11. If you have a negative net income (i.e. your expenses exceed your income), you will have to seriously re-evaluate your spending habits.
12. If you have a positive net income, transfer the bulk of this amount to your savings account, unit trust or any other savings facility identified in step 5.
Leaving the money in your bank account will lead to the temptation of unnecessary spending.
13. After a month or two, you should have been able to identify and quantify your spending, which means it's time to have another look at possible ways in which you can cut back on them.
14. Set realistic goals in order to cut back on expenses by starting with the biggest expense first and then work your way down.
15. Keep your budget up to date and be sure to evaluate your budget on a monthly basis going forward.

It's extremely important that you take a realistic approach when preparing your budget. Keep in mind that you are not trying to impress anyone; you are working towards creating a prosperous future for yourself. More importantly, be disciplined and stick to your budget under all circumstances. It is the only way that you will be able to safely navigate the temptation of unnecessary spending and debt. ■

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Market punishes Massmart

BY LUCAS DE LANGE

There are very few things that you can be sure of when you invest in shares, but it is accepted that, in the final instance, earnings rule the roost when it comes to determining share prices. It is significant in this regard that Massmart, which recently announced a 26% decline in headline earnings per share for the six months to end June, has landed among the poorest performing shares on the JSE. The share, which caught the imagination of many investors when it was acquired by Walmart, has now tumbled by about 49% since reaching its historic high in May 2013.

There is a belief that Walmart's input – such as groceries at Game – is not as successful as originally anticipated. For example, it is very difficult to take on competitors such as Shoprite/Checkers, Pick n Pay and Woolworths in shopping centres.

That there has been an underlying weakening in the market has been borne out by the fact that the number of shares whose closing prices are 10% or more above their individual 200-day exponential moving average (EA) has dropped to 52% of the 100 biggest shares in terms of market cap. The feeling among most investment managers seems to be that the current weakness should rather be seen as a buying opportunity. Nevertheless, some admit that they are increasing their exposure to defensive shares.

At the same time, there are warning signs that, with the local economy currently so weak that we could end up in recession, precautions should be taken. Even a favourite such as Mr Price is experiencing pressure as it has weakened by some 28% since April.

There is an uneasiness about what's happening on the New York Stock Exchange, the world's foremost bourse. For example, New York's general 12-month moving average, an indicator regarded by many market players as important, has headed south for the first time in four years. The trend is confirmed by the S&P 500, which recently experienced its biggest downturn since 2011 when it dropped by almost 22%. At the

time, the JSE's All Share Index declined by just over 15%, which did offer good buying opportunities.

Nevertheless, it should be borne in mind that the JSE, like most stock exchanges, tends to follow New York.

It is noteworthy that banks and insurance companies have made their appearance among the weakening shares. Even Sanlam, which has performed remarkably for its shareholders since 2009, has retracted to such an extent that its long-term moving average (200 days) has shown a downward reversal for the first time since 2009. MMI and Liberty Holdings have also reversed. Of the banks, shares like Standard Bank and Nedbank look weak. FirstRand is, as usual, the strongest among the heavies.

Of the shares that are breaking through their 200-day moving average, Truworths, Vukile, Shoprite and Aquarius look interesting. With regard to the last-mentioned, there are 10 consensus analysts who believe it's a buy. And in the case of Royal Bafokeng, there are a somewhat unusual nine buy recommendations. ■

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STRONGEST STOCKS % ABOVE 200-DAY EA

1.	PSG	92.8
2.	MONDI PLC	79.3
3.	PIONEER FOODS	76.9
4.	MONDI LTD	76.7
5.	MPACT	69.5
6.	CAPITEC	68.6
7.	RESILIENT	68.5
8.	KAP	64.6
9.	STEINHOFF	61.3
10.	NASPERS-N	46.5
11.	DISCOVERY	44.4
12.	DATATEC	43.8
13.	HYPROP	41.1
14.	NETCARE	38.2
15.	WOOLWORTHS	36.96
16.	SPAR	36.4
17.	MEDICLINIC	35.8331
18.	RMI HOLDINGS	34.7
19.	CLICKS	34.6
20.	ASTRAL	33.9
21.	DISTELL	33.3
22.	SUPER GROUP	30.9
23.	AVI	30.7
24.	FIRSTRAND	29.8
25.	TELKOM	29.3
26.	BAT	29.1
27.	CAPPROP	28.7
28.	PICK N PAY	27.99
29.	INVESTEC PLC	27.9
30.	INVESTEC LTD	26.4
31.	RMB HOLDINGS	26.1
32.	BIDVEST	26.03
33.	OLD MUTUAL	24.6
34.	ASPEN	23.4
35.	TFG	22.9
36.	MR PRICE	21.9
37.	BLUETEL	21.7
38.	REMGRO	21.3
39.	SABMILLER	21.2
40.	CITY LODGE	20.95
41.	SA CORP	20.85

*Based on the 100 largest market capitalisations

WEAKEST STOCKS % BELOW 200-DAY EA

1.	LONMIN	-73.99
2.	ARCELOMITTAL	-52.6
3.	AVENG	-51.5
4.	KUMBA IRON ORE	-50
5.	HARMONY	-49.3
6.	GLENCORE	-46.6
7.	ALTRON-A	-42.6
8.	ASSORE	-38.7
9.	ARM	-35.02
10.	EXXARO	-31.02
11.	IMPLATS	-29.3
12.	ANGLO	-26.8
13.	ILLOVO	-26.2
14.	MASSMART	-21.5
15.	PAN AFRICAN	-21.4
16.	NAMPAK	-20.1
17.	M&R HOLDINGS	-18.9
18.	LEWIS	-18.3
19.	MTN GROUP	-17.03
20.	SUN INTERNATIONAL	-16.3
21.	BHP BILLITON	-15.7

BREAKING THROUGH % ABOVE 200-DAY EA

1.	TRUWORTHS	7.8
2.	VUKILE	6.99
3.	SHOPRITE	4.8
4.	GROWTHPOINT	3.6
5.	CORONATION	2.2
6.	AQUARIUS	0.9

Know your market

BY JACO VISSER

Textbook notions of a target market can be overrated, says director of the Rhodes Business School, Prof. Owen Skae. He told *Finweek* how entrepreneurs should study their target markets.

Potential entrepreneurs who have identified a gap in the market – whether it is a product or service they wish to deliver – need to know how to deal with different types of customers.

Broadly speaking, three types of potential customers can be identified: private individuals, other businesses and government. Having a solid understanding of these groups could boost the entrepreneur's chances at start-up, but the fundamental issues of customer service and commitment to quality will loom large.

"Often too much is made about the textbook notion of a target market," says Prof. Owen Skae, director of the Rhodes Business School in Grahamstown.

"While it is important to understand customer groupings and market segments, the common denominator will always be an absolute commitment to customer service."

A further challenge when dealing with the government or big businesses is that excellent customer service alone will not boost the entrepreneur's chances of success. With these two types of customers, according to Skae, the small-business owners may have to go through a tendering process.

"South Africa still has a long way to go in terms of government and big businesses buying from smaller businesses," says Skae. In Japan, for example, government is obliged to pay smaller companies ahead of other suppliers and with a tighter timeframe, he says. "Tendering in South Africa can be intimidating and costly."

Delivering a promised or contracted product or service could be critical in securing a long-term relationship with either government or big businesses. Finding the correct pricing of the goods and services to be sold is also essential, according to him.

"It is very important for the potential entrepreneur to familiarise him or herself with the quantity of products or services that a customer wants and to get the ballpark value that will lead to a competitive price," says Skae. "Getting this right could be the big break you want or, if you get it wrong, it could be your demise."

One of the main reasons why smaller companies go bust is that they overtrade. These companies tend to grow too fast,



Prof. Owen Skae
 Director of the Rhodes
 Business School

making a profit while not generating enough cash, according to Skae.

Problems then arise when the business owner realises they can no longer afford to pay their suppliers. On the other hand, if only one debtor fails to pay what they owe, that could be the firm's death blow.

When potential entrepreneurs seek new business, they need to be wary of over-promising and under-delivering, he says.

"Impeccable service is paramount when selling to individual customers as word-of-mouth advertising is very important," says Skae.

The internet has reduced the cost of traditional market research, according to him. In addition to utilising the web to do research, observing other businesses in action is another powerful tool in scouring the market.

"Observing people making their purchases, how they compare prices and decide to purchase could be valuable to your market research," he says. He adds that trade publications, covering each different sector of the economy, are often a valuable source of information.

Skae advises that every potential entrepreneur should have a strategy, especially a business and marketing plan. These plans should be used as a guide for the entrepreneur, especially in difficult times and not necessarily as a tool to get bank funding. ■

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GET TO KNOW YOUR MARKET

There are a couple of free or low-cost methods that an entrepreneur could use to gauge a potential target market, according to Prof. Owen Skae, director of the Rhodes Business School:

- Do research online – especially to find statistics on a target population.
- Talk to potential customers – understand what they would like to be different about your product or service.
- Carry out market surveys – employ students to conduct surveys with potential customers or clients.
- Observe – watch people in other businesses, such as shops, and how they react to price changes and interact with trusted brand names.
- Scour trade publications – here you may find potential customers or clients.

Apple and Massmart team up smartly

BY GUGU LOURIE

Two American firms – **Apple and Massmart** – are teaming up to conquer the smart device market in South Africa, which is presently dominated by three top brands: Nokia, Samsung and BlackBerry.

Although Nokia and BlackBerry's share of the global mobile market is diminishing, these brands remain popular in SA. This was confirmed in the *Mobile Africa 2015* study recently conducted by GeoPoll and World Wide Worx, which surveyed 3 500 mobile phone users in five of Africa's major markets, namely SA, Nigeria, Kenya, Ghana and Uganda. According to the study, 36% of participants in SA preferred Nokia; 21% preferred Samsung and 14% BlackBerry. While 6% of all 3 500 participants indicated they had a BlackBerry, 17% indicated their next phone would be a BlackBerry. This is in stark contrast to its global figures; global research firm IDC estimates that BlackBerry controls 0.3% of the global smartphone market.

The *Mobile Africa* study confirmed a widely held view that Nokia remains the single biggest phone brand in the major African markets. However, its market share is plummeting fast, according to the study. It also found that old BlackBerrys have entered the mass market, and are still regarded as a status symbol in much of Africa.

Meanwhile China's smartphone giant Xiaomi is also planning to enter the South African market. Apple seems to be preparing itself for an onslaught from Xiaomi in SA, a market in which its iPhone enjoys a share of 5%.

AN ALLURING ALLIANCE

It is against this background that JSE-listed retailer Massmart, which is owned by US retail conglomerate Walmart Stores, quietly teamed up with US technology giant Apple.

Massmart CEO Guy Hayward informed investors via the JSE that they were "excited that nine stores (DionWired) have been selected recently to become Apple White Stores". Massmart, which imports most of its electronic products, didn't provide further information on DionWired stores and the deal with Apple.

DionWired stores provide a wide range of discerning brands such as Apple, Smeg, Marantz, Bose and Onkyo to the South African higher-income consumer.

Apple is partnering with Massmart in order to target high-end customers frequenting DionWired. It also wants to make its brand more prominent ahead of its rivals such as Samsung, Huawei and Sony.

Massmart said the first DionWired outlets to receive the White Store makeover would include Gateway in Durban and the Canal Walk and Somerset West stores in the Western Cape. "The stores will be designed by Apple US to give you the Apple experience; even the store fixtures will be set up by a specialist team," DionWired director, Nazim Cassim, said.

"The whole store will not be branded Apple, but will have a dedicated

MASSMART PLAYING ONLINE

IN NOVEMBER 2014, Massmart's Makro revealed plans to launch a locker-based pick-up service as a means to provide additional delivery options for shoppers. This new delivery option was to supplement the home delivery and in-store click and collect solutions already offered by Makro stores.

"We remain excited at the potential of this channel," the company informed investors. "Analysis of online customer purchasing behaviour has indicated that click-and-collect customers typically make further purchases in-store when collecting their online purchases."

"While still effectively in test-phase, the new Makro pick-up locker project demonstrates our willingness to innovate, and during September 2015 we will launch a Commercial Customer online solution."

Apple area, which will be branded in accordance with Apple corporate identity. To date, we have approved nine stores for the roll-out."

For Massmart, this partnership represents a possible opportunity to further diversify its revenue streams or bulk up DionWired sales for smart devices; for Apple the partnership could be a strategy to position itself in a high-end retail space and prepare for competition from Xiaomi.

The official myistore.co.za website currently lists 20 Apple iStores in SA. Between 2007 and 2014, Apple grew its number of stores worldwide from 197 to 437. ■

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Directors' Dealings

Company	Director	Transaction Date	Transaction Type	Volume	Price (c)	Value (R)	Date Modified
AMECOR	D Colley	3 September	Purchase	151,662	220	333,656	4 September
ARGENT	SJ Cox	4 September	Purchase	6,228	400	24,912	7 September
BIDVEST	AW Dawe	3 September	Sell	38,044	32332	12,300,386	4 September
BRIMSTONE	T Moodley	3 September	Exercise Options	7,268	550	39,974	4 September
DISTELL	NT Moodley	2 September	Sell	3,761	17210	647,268	7 September
DISTELL	NT Moodley	2 September	Sell	5,667	17245	977,274	7 September
DRDGOLD	DJ Pretorius	4 September	Purchase	100,000	215	215,000	7 September
GOLD FIELDS	PA Schmidt	2 September	Sell	19,871	3988	792,455	4 September
GOLD FIELDS	PA Schmidt	2 September	Sell	27,440	4217	1,157,144	4 September
GROWPNT	D Bouma	4 September	Sell	5,588	2545	142,214	7 September
GROWPNT	D Bouma	4 September	Exercise Options	5,587	2568	143,474	7 September
GROWPNT	EK De Klerk	4 September	Sell	123,436	2545	3,141,446	7 September
GROWPNT	EK De Klerk	4 September	Exercise Options	177,629	2568	4,561,512	7 September
GROWPNT	RA Krabbenhoft	3 September	Purchase	13,165	2564	337,550	4 September
GROWPNT	RA Krabbenhoft	3 September	Purchase	19,747	2570	507,497	4 September
GROWPNT	G Muchanya	1 September	Sell	55,672	2564	1,427,430	4 September
GROWPNT	G Muchanya	1 September	Purchase	32,626	2561	835,551	4 September
HYPROP	KM Ellerine	3 September	Purchase	7,396	12175	900,463	8 September
HYPROP	KM Ellerine	4 September	Purchase	92,604	12259	11,352,324	8 September
ITALTILE	BG Wood	1 September	Exercise Options	1,000,000	1143	11,430,000	3 September
ITALTILE	BG Wood	1 September	Exercise Options	500,000	1182	5,910,000	3 September
ITALTILE	BG Wood	28 August	Sell	89,762	1150	1,032,263	3 September
LIB HOLD	T Dloti	1 September	Sell	10,397	12428	1,292,139	3 September
LIB HOLD	JM Parratt	1 September	Sell	723	12428	89,854	3 September
MIXTEL	B Horan	2 September	Exercise Options	750,000	313	2,347,500	7 September
MIXTEL	SB Joselowitz	2 September	Exercise Options	1,000,000	313	3,130,000	7 September
MIXTEL	G Pretorius	3 September	Exercise Options	500,000	313	1,565,000	7 September
MIXTEL	ML Pydigadu	1 September	Exercise Options	750,000	313	2,347,500	7 September
MIXTEL	ML Pydigadu	1 September	Exercise Options	66,667	315	210,001	7 September
MIXTEL	CWR Tasker	2 September	Exercise Options	750,000	313	2,347,500	7 September
OMNIA	WT Marais	1 September	Sell	95,832	17000	16,291,440	8 September
PRESCIENT	M Buckham	7 September	Purchase	1,000,000	100	1,000,000	8 September
ROCK	A Van Der Veer	1 September	Purchase	34,025	2935	998,633	7 September
SPANJAARD	BL Montgomery	1 September	Sell	292	410	1,197	8 September
SUN INT	B Modise	2 September	Purchase	5,000	9961	498,050	3 September
SUN INT	B Modise	2 September	Purchase	500	9961	49,805	3 September
SUN INT	B Modise	2 September	Purchase	500	9961	49,805	3 September
SUN INT	GE Stephens	2 September	Purchase	10,029	9971	999,991	3 September
WOOLIES	SAR Rose	7 September	Purchase	1,031	9650	99,491	8 September

Dividend ranking

SHARE	FORECAST DPS (c)	FORECAST DY (%)	SHARE	FORECAST DPS (c)	FORECAST DY (%)
EQSTRA	32	11.1	LEWIS	528	8.4
DRDGOLD	25	11.0	GLENCORE	233	8.3
REBOSIS	109	10.3	FORTRESSA	129	8.2
PAN AFRICAN	15	9.3	ACCPROP	54	8.2
EMIRA	146	8.8	VUKILE	148	8.2



TEST YOUR KNOWLEDGE

Welcome to another quiz! This week we've got another great book to give away, this time by world-renowned philosopher and writer Noam Chomsky. For a chance to win a copy of *Because We Say So*, in which Chomsky comments on US politics and foreign policies, complete the online version of this quiz on finweek.com. Good luck!

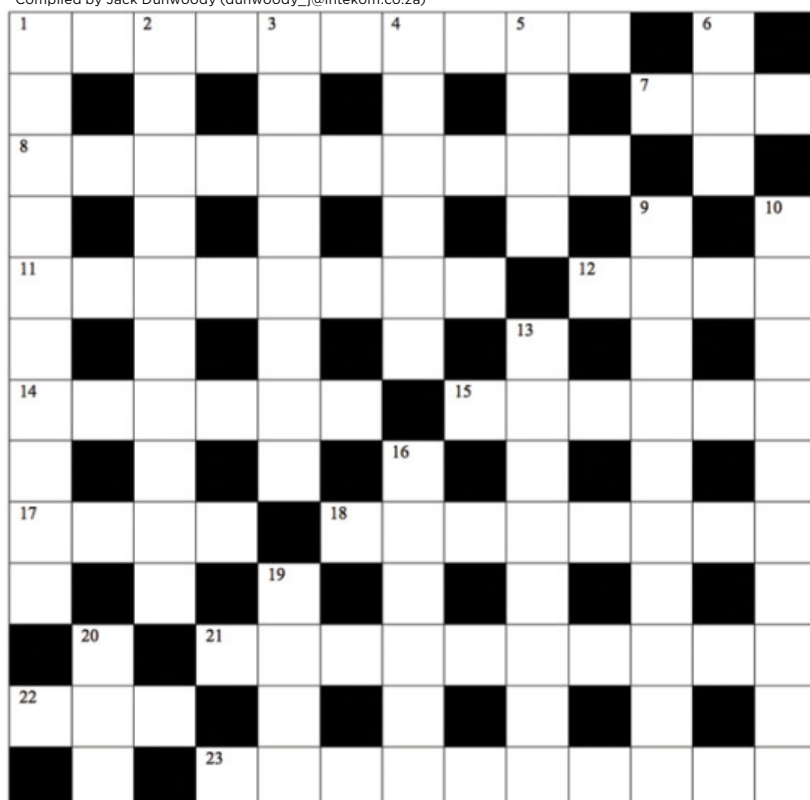
finweek

1	Name the sport Andy Murray plays.	6	Joice Mujuru is a politician in a neighbouring country. Name this country.
2	Who is the longest reigning UK monarch? ■ Queen Victoria ■ King Richard III ■ Queen Elizabeth II	7	In local politics, who is Collen Maine?
3	Sanral needs R1.5bn to make safety upgrades to a certain tunnel in the Western Cape. Name this tunnel.	8	True or false? Bafana Bafana lost against Mauritania in the Afcon 2015 tournament.
4	True or false? The SA government wants to allow its citizens to have dual citizenship.	9	Which European country recently reversed the decision to impose the limit on the number of migrants it would accept? ■ Germany ■ Hungary ■ The UK
5	True or false? The Nelson Mandela Metropolitan University is also known as Maties.	10	True or false? The website News24 is going to disable its comments section.

CRYPTIC CROSSWORD

Compiled by Jack Dunwoody (dunwoody_j@intekom.co.za)

NO 599 JD ACROSS



- 1** It is firstly a hamstring inflammation (10)
- 7** Caper I can't start without soldier (3)
- 8** Band's number one bellwether (10)
- 11** Wrecked complete display (8)
- 12** Not sea-blue water (4)
- 14** Sounds like the fat of the land (6)
- 15** Isn't a railway advocate (6)
- 17** Dead notes (4)
- 18** Dandy pretending to like Continental style pasta (8)
- 21** Rival worker activity in an Ulster station (10)
- 22** Choose to come back in a different position (3)
- 23** He will mobilise resistance and be a troublemaker (4-6)

DOWN

- 1** Succeed as an alchemist? (4,2,4)
- 2** Beginning of the second round or where to get out of it after the first? (10)
- 3** Discharge from ship at medium fast pace (3,5)
- 4** Girl is a shade unwell?
- 5** That is time out of time (4)
- 6** Tip off Heather to sign (3)
- 9 & 20** A Paras CO's squib damaged exercise hydro (10,3)
- 10** Nanny, newborn and easy to catch (4,6)
- 13** Drink seven times secret formula (4-4)
- 16** Claim a change of armour (6)
- 19** She sits in the middle of the orchestra, we hear (4)
- 20** See 9

Solution to Crossword NO 598 JD

ACROSS: 1 Bradycardia; 9 Fin; 10 Innkeeper; 11 Tense; 13 Cheat on; 14 Eggnog; 16 Ordeal; 18 Astream; 19 Motet; 20 Loan shark; 21 Err; 22 Temporarily
DOWN: 2 Ran; 3 Drive; 4 Conics; 5 Roe deer; 6 Impatient; 7 Off the rails; 8 Translators; 12 Nightmare; 15 Opens up; 17 Impair; 19 Maker; 21 Ell

ON MARGIN

Piker has observed some dejected graphic designers in the *Finweek* newsroom over the years, but is yet to receive a bill that quantifies their frustrations with picky editors. That's not the case everywhere, it seems, with the following price list making the rounds on social media:

I design everything	\$100
I design, you watch	\$200
I design, you advise	\$300
I design, you help	\$500
You design, I advise	\$1 300
You design, I watch	\$2 100
You design everything	\$3 400

INFIDELITY

Things are just heating up between John and Lucy when the phone rings. Lucy answers – it's her husband. Freaking out, John starts getting dressed.

Lucy hangs up. "Don't worry," she says. "He says he'll be home late – he's out drinking with you."

SELLING SOFTWARE

A software manager, a hardware manager and sales manager are driving to a

meeting when a tyre bursts. They get out of the car and look at the problem. The software manager says: "I can't do anything about this – it's a hardware problem."

The hardware manager says: "Maybe if we turned the car off and on again, it would fix itself."

The sales manager says: "Hey, 75% of it is working – let's ship it!"

THE STARTING SALARY

Reaching the end of a job interview, the HR officer asked the young MBA graduate fresh out of Gibbs: "And what starting salary were you looking for?"

The candidate said: "In the neighbourhood of R900 000 a year, depending on the benefits package."

The HR officer said: "Well, what would you say to a package of five weeks' paid holiday, full medical aid, a retirement fund offering 50% of your salary, and a company car leased every two years – say, a red BMW?"

The graduate sat up straight and said: "Wow! Are you joking?"

And the HR officer said: "Of course... but you started it."



"I should've installed one of these years ago."



Tom Eaton @TomEatonSA

According to Wikipedia, Mauritania's chief exports are iron ore, seafood, oil, copper, and as of 2015, embarrassment for Itumeleng Khune.

Sabelo Ndlangisa @Bhintsintsi

Do they really call it #ANCYL – The Legacy?

Karin Richards @Richards_Karin

Now almost 10 Lonmin shares for a cup of coffee in London.

Rick-Rack Cadillac @irCadillac

Woolworths is removing sweets from the checkout aisles and replacing them with pen and paper for people to write their #News24Comments.

Karin Richards @Richards_Karin

Looks like a [Stikeez]-less Shoprite may be heading to R138.

Neil Slabbert @slabss

@Richards_Karin ag no man...

Karin Richards @Richards_Karin

@slabss Whitey best find an answer to this. Cheaper baked beans ain't gonna do it.

"Don't ask the barber whether you need a haircut." – Daniel S. Greenberg, American journalist and author (1931-)

"Wall Street's graveyards are filled with men who were right too soon." – William Hamilton (1967-1929), fourth editor of *The Wall Street Journal*



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